



# Abertay University

**Regulating Securities Market Abuse: A Comparative Legal Study of United  
Kingdom and Kingdom of Saudi Arabia's Financial Regulatory Systems**

A Thesis Submitted to the University of Abertay Dundee  
in Partial Fulfilment of the Requirements for the Degree of Doctor of  
Philosophy in Law

Marzouq Almutairi

University of Abertay Dundee

**2016**

## Contents

Legislations .....	5
Case law .....	7
List of Abbreviations .....	viii
<b>ABSTRACT.....</b>	<b>x</b>
<b>Acknowledgment.....</b>	<b>xi</b>
<b>Chapter One: Introduction .....</b>	<b>1</b>
<b>1.1 Purpose of the research .....</b>	<b>1</b>
<b>1.2 Significance of the study .....</b>	<b>2</b>
<b>1.3 Methodology .....</b>	<b>4</b>
<b>1.4 Structure .....</b>	<b>5</b>
<b>1.5 General Introduction .....</b>	<b>6</b>
<b>1.6 Islamic economic principles .....</b>	<b>11</b>
<b>1.7 Saudi Arabia's ambition for a developed and open financial market system     that converges with global standards.....</b>	<b>14</b>
<b>Chapter Two.....</b>	<b>18</b>
<b>Developing market products and services through innovation and constraints....</b>	<b>18</b>
<b>2.1 Introductions .....</b>	<b>18</b>
<b>2.2 Developing Islamic financial market amidst systemic constraints.....</b>	<b>20</b>
<b>2.3 Innovations and harmonisation .....</b>	<b>29</b>
<b>2.4 Challenges of Shari'ah compliance .....</b>	<b>31</b>
<b>2.5 Discussing compatibility: Islamic vs. Western regulatory approach.....</b>	<b>36</b>
<b>2.6 Conclusion .....</b>	<b>41</b>
<b>Chapter Three .....</b>	<b>45</b>
<b>Transformation of the Islamic Capital Market Economy: A conceptual perspective     .....</b>	<b>45</b>
<b>3.1 Introduction.....</b>	<b>45</b>
<b>3.2 The concept of Islamic customs in finance (Urf).....</b>	<b>45</b>
<b>3.3. Islamic financial products: Sukuk and other instruments .....</b>	<b>48</b>
(a). <i>Mudarabah and Musharakah</i> .....	49
(b). <i>Murabaha</i> .....	52
(c). <i>Ijarah</i> .....	52
(d). <i>Istinsa</i> .....	56
(e). <i>Takaful</i> .....	56
(f). <i>Qard Hasan</i> .....	58
<b>3.4 Alternative innovations in futures and bonds commodities.....</b>	<b>59</b>
(a). <i>The legitimacy of bonds</i> .....	60
(i). <i>Ijarah bonds</i> .....	62
(ii). <i>Istisna bonds</i> .....	63
3.4.1 The structure of Istisna bond.....	64
(iii). <i>Mudaraba and Musharaka bonds</i> .....	66
<b>3.5 Conclusion .....</b>	<b>67</b>

<b>Chapter Four</b>	<b>70</b>
<b>Market Abuse: A theoretical perspective</b>	<b>70</b>
<b>4.1 Introduction</b>	<b>70</b>
<b>4.2 Different strands of arguments about market abuse</b>	<b>72</b>
4.2.1 Utilitarian approach	72
4.2.2 The rights-based approach	74
4.2.3 Level playing field theory	77
4.2.4 Fiduciary duty argument	80
4.2.5 Fairness vs. fraud argument	82
<b>4.3. Islamic theory</b>	<b>83</b>
4.3.1 Duty of the State in regulating market	84
4.3.2 Principles on dishonesty in dealings and abuse of market	85
<b>4.4 Conclusion</b>	<b>86</b>
<b>Chapter five</b>	<b>89</b>
<b>Legal framework for financial market regulation, Saudi Arabia and the United Kingdom</b>	<b>89</b>
<b>5.1 Introduction</b>	<b>89</b>
<b>5.2 Structuring of the Saudi Arabian financial market</b>	<b>89</b>
5.2.1 The Capital Market Law (CML)	92
5.2.2 General framework of the CML	95
5.2.3 Regulations under the CML	97
(a) Regulation on market abuse	97
(b). Regulations on Initial and continuous Disclosure	105
(c). Regulation on dispute and violations.	106
(d). Regulation on jurisdictional boundaries	107
(e). Regulation on exclusion of instrument.	108
<b>5.3 Framework of UK Market laws</b>	<b>109</b>
5.3.1 The Criminal Justice Act (CJA) 1993	110
5.3.2 The Financial Services and Markets Act 2000 (FSMA)	111
<b>5.4 MAD and MAD II</b>	<b>117</b>
<b>5.5 Conclusion</b>	<b>119</b>
<b>Chapter Six</b>	<b>122</b>
<b>The Nature and Trajectories of Regulatory Authorities: Saudi Arabia and the UK</b>	<b>122</b>
<b>6.1 Introduction</b>	<b>122</b>
<b>6.2 The Capital Market Authority (CMA)</b>	<b>123</b>
6.2.1 Structure of the CMA	125
6.2.2 Role of the CMA	125
(a). Regulatory	125
(b). Publicity and public awareness.	127
(c) Swap agreements as means of attracting foreign investment.	128
<b>6.3 The UK regime.</b>	<b>132</b>
6.3.1 From the FSA to FCA	133
<b>6.4 Conclusion</b>	<b>139</b>

<b>Chapter Seven .....</b>	<b>141</b>
<b>Enforcement and Penal Regime in the UK and Saudi .....</b>	<b>141</b>
<b>7.1 Introduction.....</b>	<b>141</b>
<b>7.2 Structure of penal regime for market abuse in the United Kingdom .....</b>	<b>142</b>
7.2.1 Nature of criminal sanction for market abuse in the United Kingdom.....	143
7.2.2 Nature of civil responsibility in the UK.....	149
<b>7.3 Challenges of market size in the UK .....</b>	<b>152</b>
<b>7.4 Regional legislation on enforcement.....</b>	<b>153</b>
<b>7.5 Framework of penal enforcement under the Saudi Arabia financial market regime.....</b>	<b>155</b>
7.5.1 Causes of action in Saudi Arabia.....	158
7.5.2. Procedure for investigation and trial in Saudi.....	160
7.5.3 Nature of penalty in Saudi .....	162
<b>7.6 Conclusion .....</b>	<b>164</b>
<b>Chapter Eight.....</b>	<b>167</b>
<b>General conclusion.....</b>	<b>167</b>
<b>8.1 General conclusion and recommendation .....</b>	<b>167</b>
<b>8.2 Recommendations. ....</b>	<b>180</b>
<b>Bibliography .....</b>	<b>182</b>

## **Legislations**

### **United Kingdom Law**

Limited Partnership Act 1907.

Companies Securities (Insider Dealing) Act 1985

c.8. Criminal Justice Act 1993 c.36.

Financial Services Act 2012 (FSAct) 2012 c.21.

Financial Services and Markets Act (FSMA) 2000

c.8.

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2002/682

Financial Services and Markets Act 2000 (Regulated Activities) Order 2001/544

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2001/3544

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 2) Order 2003/1476

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 1) Order 2003/1475

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 3) Order 2003/2822

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2004/1610

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment)(No.2) Order 2004/2737

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2005/1518

Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) (Amendment) Order 2005/922

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2005/593

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment No. 3) Order 2006/3384

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2006/2383 Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2006/1969

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order

2007/1339 Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 2) Order 2007/3510

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2009/1342

Financial Services and Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 2) Order 2009/1389

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2010/86

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2010/86 • Financial Services and

Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2016.

### **European Union Laws**

European Council Directive 2001/34/EC. L 184/1

EU Market Abuse Directive (MAD) 2003/6/EC. L 96/16 2003.

Directive 2004/72/EC. L 162/70

Directive 2003/124/EC. L

339/70 Directive 2003/125/EC L

339/73

Market Abuse Regulation (MAR) (EU) No 596/2014. L 173/1

Directive on Criminal Sanctions for Market Abuse (CSMAD). 2014/57/EU. L 173/179. Commission Implementing Directive (EU) 2015/2395. L332/1

### **Kingdom of Saudi Arabia laws**

Royal Decree No. M/11, 29/05/1404H (Jan. 3, 1984).

Royal Decree No. M/35, 28/12/1412H (June 28, 1992).

Royal Decree No. M/35, 28/12/1412H (June 28, 1992). Saudi Capital Market Laws (CML) 2003.

Royal Decree No. M/30 of 2/5/1424H (July 31, 2003).

Royal Decree No. 2-11-2004, 20/8/1425H (April 10, 2004). Royal Decree No. 1-11-2004, 20/8/1425H (April 10, 2004).

Offers of Securities Regulations 20/8/1425H<sup>v</sup> (10 April, 2004). Royal Decree No. M/25, 4/5/1425H (June 22, 2004).

Royal Decree No. 1-83-2005, 21/05/1426H (June 28, 2005).  
 Royal Decree No. 2-83-2005, 21/05/1426H (June 28, 2005).  
 Capital Market Authority Board Resolution, No. 2-128-2006.  
 Royal Decree No. 1-193-2006, 19/6/1427H (July 15, 2006).  
 Royal Decree No. 1-212-2006, 21/10/1427AH (Dec. 11, 2006).  
 Royal Decree No. 1-50-2007, 21/9/1428H (Mar. 10, 2007).  
 Board of the Capital Market Authority Resolution No. 1-39-2008, 3/12/1429H (Jan. 12, 2008).  
 Capital Market Authority Board Resolution No. 1-39-2008.  
 Capital Market Authority Board Resolution, No. 1-28-2008 Saudi Stock Exchange Listing Rules.  
 Sahih Muslim (Vol. 6). Beirut: Dar El-Mareefah.  
 The Holy Quran Translation by Abdullahi Yusuf Ali.

### **Case law**

*David Massey v The Financial Service Authority*, [2011] All ER (D) 95 (Feb)  
*Davidson and Tatham v Financial Services Authority* [2006] UKFSM FSM031.  
*Engels v Netherlands*, ECHR 3, 5100/71, (1976) 1 EHRR 647.  
*FCA v Da Vinci Invest Limited and Others* [2015] EWHC 2401 (Ch).  
*Grande Stevens and Others v Italy* (App No.18640/10, 18647/10, 18663/10, 18668/10). (2014) ECtHR 4 March 2014.  
*Hannam v FCA* [2014] UKUT 0233.

*Ipourgios Ikonomikon Proistamenos DOI Amfissas v Charilaos Georgakis* Case C-391/04.

*Kenneth George Carver* FCA Notice, 30<sup>th</sup> March, 2015.

*Mackie v HMA* [1994] JC 132.

*Markus Gelil v Daimler AG* [C-19/11].

*R v Gosh* [1982] QB 1053.

*R v Grunwald* [1963] QB 935.

*R v Hayes* [2015] EWCA Crim 1944.

*R v Page* [1996] Crim LR 821.

*Spector Photo Group NV, Chris Van Raemdonck v. Commissie voor het Bank Financien en Assurantiewezen* (CBFA), Judgment of the European Court of Justice (Third Chamber) of 23 December 2009, Case C-45/08,

*United States v. O'Hagan*, 521 U.S. 642, 1997.

*Winterflood Securities Ltd & Ors v Financial Services Authority* [2009] UKFSM FSM066.

### **List of Abbreviations**

ACRSC	Appeal Committee for the Resolution of Securities Conflicts.
AAOFI	Accounting and Auditing Organization of Islamic Financial Institutions.
BCMAR	Board of the Capital Market Authority Resolution.
CJA	Criminal Justice Act.
CMA	Capital Market Authority.
CMABR	Capital Market Authority Board Resolution.
CMBR	Capital Market Authority Board Resolution.
CML	Capital Market Law.
COMAC	Code of Market Conduct.
CPL	Criminal Procedure Law.
CRSD	Committee for the Resolution of Securities Disputes.
CSMAD	Criminal Sanctions for Market Abuse Directive.
ECD	European Council Directive.
FCA	Financial Conduct Authority.
FSA	Financial Service Act.
FPC	Financial Policy Committee.
FSC	Financial Strategy Committee.
FSMA	Financial Services and Markets Act.
IOSCO	International Organization of Securities Commissions.
LSE	London Stock Exchange.
MAD	Market Abuse Directive.
MAR	Market Abuse Regulation.
OSR	Offers of Securities Regulations.
PRA	Prudential Regulation Authority.



RDC	Regulatory Decisions Committee.
SAMA	Saudi Arabian Monetary Authority.
SIB	Securities and Investments Board Limited.
SSE	Saudi Stock Exchange Listing Rules.
UCITS Securities.	Undertakings for the Collective Investment in Transferable
WTO	World Trade Organisation.

## **ABSTRACT**

Financial markets play a crucial role in the development of trade and investment across the world. They have also helped in shaping the economy of many countries through emerging resolve to diversify their economy by building financial markets that are attractive to both domestic and foreign investors. But beyond the participation of investors, there has been continuous determination to establish robust regulatory frameworks in order to make the market safer for investors and for the economy. To achieve this, the need for effective legislation and proper enforcement against market abuse has become a prominent part of policy decisions across nations and regions. This work looks at the development of financial market in the Kingdom of Saudi Arabia in comparison with developments in the United Kingdom. In doing so, the study makes a contribution to the field of knowledge by critically discussing the challenges of emerging markets such as Saudi Arabia in not only expanding its financial industry but in restructuring the industry with new regulations, products and services that are also protected from market abuse. The study is also one that for the first time, compares these two jurisdictions in the context of financial market regulations and legal mechanisms against market abuse.

The study examines these regimes from a legal perspective, by looking at the development of the two financial markets regimes and especially the way regulatory frameworks modelled and implemented to deal with market abuse. The thesis also looks at the critical issues and challenges of dealing with insider trading and market manipulation in the face of Saudi's growing ambition to reach out to the global market while keeping its traditional model of Islamic finance. These issues were discussed in comparison to the model in the UK and how the UK legal framework works to curtail abuse of the market, ensure compliance and investor safety as well as issues relating to penalties for offenders. The thesis further relates these aspects of financial markets to the challenges of dealing with the growing volume of products and services that are becoming increasingly sophisticated in a global market that has continued to become interconnected.

## **Acknowledgment**

I am deeply indebted to Allah for giving me the strength to come this far; I have nothing to give back but my gratitude.

I will also wish to acknowledge my supervisor Mr. Kenneth Swinton of the University of Abertay, Scotland, for his support, kindness and patience throughout my course of study. His advice and guidance has particularly invaluable for me.

I wish to also thank my family, especially my wife and kids for understanding that even when I spend the day being hold up quietly at the corner of my study, with my computer, I am doing it all for us. My gratitude also goes to my parents who always give me the courage and support to carry on.

Nothing could have been possible without all the people I have mentioned here. To my friends and colleagues at the University of Abertay and across the country, I will love to say you are all amazing and your company has been a great motivator.

## **Chapter One:**

### **Introduction**

#### **1.1 Purpose of the research**

This study aims to examine the structure of Saudi Arabia's financial market and the nature of its regulatory institutions in comparison to the system in the United Kingdom. It looks at the various characteristics that define the financial institutions, ranging from aspects of development to those of reform. The study also aims to discuss and analyse the nature and character of the various products and services; from the traditional to the modern in an effort to understand how the Saudi market has changed over the decades and the extent to which its contemporary character match with the financial system in the UK and beyond. Further, this study intends to explain the complexities and challenges surrounding Saudi Arabia's quest for expansion of its financial market and the challenges of preserving traditional Islamic values. It also looks at aspects of financial market regulations in Saudi Arabia and the United Kingdom in the context of their convergence and divergence on the principal aspects of transparency, ethics and enforcement of rules on the protection of market participants and penalisation of violations.

The study then looks at the experience of the Saudi financial market through its transitional period to what is applicable today in terms of the establishment and implementation of laws to prevent market abuse as a prime example of the requirements for transparency, ethical standards and the appropriateness of sanctions for the breach of the applicable rules. In the context of this discussion, the thesis looks at how the system in Saudi is comparable to the market regulation regime in the UK. Through contents of the Capital Market Laws and the role of the Capital Market Authority in Saudi this study looks at various regulatory developments and implementation of laws in an increasingly growing market, and that which is becoming interconnected with the global financial market.

In order to achieve these, the study looks at the financial market framework of Saudi Arabia and the UK, and attempts to answer certain important questions that include:

- a) The transition and challenges of Saudi financial market reform from a

system based on orthodox Islamic principles to one that adopts modern products and services.

- b) The contents of the various laws in Saudi Arabia and how it has shaped and reformed the current financial market, and the extent to which it can be related to western financial markets standards, especially in the UK.
- c) The extent to which the Laws against market abuse in Saudi Arabia are effective and their comparison with what is applicable in the UK.

Other areas of this research include:

- 1) Exploring the nature and process of enforcement penalties over market abuse as applied in Saudi Arabia in comparison to the UK.
- 2) Identifying specifically what constitutes financial market abuse and points of similarity and distinction between the two regimes.
- 3) Identifying the nature and reasons for the similarities and distinction in the way penalties are enforced and disputes resolved.
- 4) Examining the legal remedies for investors in Saudi as compared to the UK and the nature of prosecution and regulatory sanctions available to both jurisdictions.
- 5) Identifying the challenges of reforms, enforcements and regulations in Saudi Arabia compared to the UK and offering some recommendations.

## 1.2 Significance of the study

The need for this study was as a result of many reasons. The first is that studying Saudi Arabia's financial market, which is the largest financial market in the Arab Gulf region, gives a good understanding of the challenges of reform, as well as the extent of convergence and divergence between institutions and regulations in the Islamic world and those in the West. The research is also meant to examine financial market legislation in the Kingdom of Saudi Arabia and how laws were designed to conform to global financial market standards, as well as the extent to which this convergence resembles and how it is distinct with the framework in the United Kingdom. The research also intends to explain the nature of regulations, and the extent to which the

regulatory institutions have created a safe environment for those dealing in products and services within the financial markets leading to increasing investment from both domestic and international market participants. This area of research gives special focus to issues of insider trading and market manipulation which are the principal forms of market abuse and how the new regulatory framework keeps up with international best practices and investor confidence.

It is evident that this area of scholarship has not been dealt with extensively, and there is the need to look at some of these issues. Perhaps scholars have written about market manipulation and insider dealings, it is important to fill the gaps, especially with regards to how these regulations in the Kingdom resemble other regulations in financial markets of the west which are larger and more proliferated with different kinds of products and services. This thesis is also an attempt to look at the areas of divergence and the reasons for that divergence. While in simple and ordinary sense, one might be tempted to compare the Saudi financial market to other markets such as Malaysia, United Arab Emirate or even Pakistan (which are also emerging and have similar cultural values as Saudi Arabia), the fact that Saudi Arabia is a member of the World Trade Organisation (WTO), and has since proven to be attractive to western investors is a motivation for a study in which the comparative perspective is targeted towards financial markets in jurisdiction whose financial market, legal culture and approach to investments is bigger and different.

It is however noted that comparative legal scholarship of this nature often demands a detailed understanding of different laws in different jurisdiction that are radically different in their approach to legislation, legal reform and even jurisprudence. Yet, in areas such as commercial laws where the world is becoming increasingly interconnected and laws governing markets becoming harmonised and internationalised, comparing Saudi Arabia's financial market with that of the United Kingdom helps in opening the gate to understand how even with a great deal of disparity in culture, custom and legal structure, financial market laws of different jurisdiction are structured to serve the purpose and aspirations of investors that constantly cross both borders in search of investment opportunities. How these purposes are achieved within the context of the similarities and differences of these laws is a matter of great relevance to this research. In the end, this kind of study

highlights the legal and regulatory challenges, opportunities and future of emerging financial markets (Saudi Arabia) in comparison to leading financial markets (United Kingdom).

While this study looks at these issues, it is, like all other studies limited in its scope as it does not expand to areas such as Islamic Banking which in itself is a topical issues when one discusses areas of financial law and market development in Saudi Arabia and the United Kingdom. The relevance of this subject cannot be ignored, however, it is also an area of scholarship that may demand an extensive and comprehensive independent research which will include but not limited to banking regulations, the economics of interest-free financial system as well as the cultural and religious dynamics of the growth and development of Islamic financial principles in a world that has become largely dominated by secular neo-liberal capitalism that is often defined by a banking system that operates on lending for interest

### 1.3 Methodology

This study is based on a methodological approach that looks at the transition in financial market development, regulations and enforcement from a legal perspective. It relies on both primary and secondary data from statutes, case law and scholarly work to explain these along with a comparative study of the issues and trajectories that define what is applicable in Saudi and how it converges or diverges from what is found in the UK. This approach entails a study of the Saudi financial market laws and those of the UK, looking at the nature and character of the rights and responsibilities of market players and regulatory institutions. In doing this, the study also looks at various texts in journals and books to digest the debates on the most relevant issues regarding the two jurisdictions. Hence, an effort was made to identify the significance of regulating financial markets as well as the different priorities applicable to both regimes and how they were designed and achieved.

In a world where financial services and capital markets are becoming increasingly interconnected and their regulations harmonised in line with global standards, case work in legal research and comparative analysis has become significantly relevant to the field of knowledge. Essentially, the methodology of comparative study is key to understanding the convergence as well as the divergence of regulations and the

structural dynamics between emerging financial markets and those that are already established. This methodological framework also helps give an insight into understanding both the legal culture of different jurisdictions as well as the distinct perspectives through which regulations are formulated and enforced. The idea therefore tends to explain and resolve certain key parameters on how two different jurisdictions (here United Kingdom and the Kingdom of Saudi Arabia) the contents of legal provisions are understood; their effect on the financial market, protection of the legitimate interest of market participants as well as the regulatory framework that defines the extent and limits of accepted market behavior. By doing this, the approach of this research is to analyse both the context through which laws and regulations were influenced, promulgated and the underlying structure of regulatory bodies as they work to make the law effective and enforceable. This also suggests that the methodology is capable of explaining the cultural and religious dynamics of places like Saudi Arabia and how these social trajectories influence the design of law and regulations.

Being that this thesis is essentially comparative legal study i.e., comparing the laws of one country against that of another, a careful but comprehensive analysis was undertaken to understand the different but relevant provisions of the law and regulations by looking at various legal data points in both jurisdictions. This also includes a clear understanding and appraisal of the meaning and application of these laws. The thesis then goes on to evaluate, compare and contrast the laws under review, which gives the opportunity to understand the rationale for the similarities and the reasons for the differences. It also entails contextualising the functionality and relevance of these laws to each of the jurisdictions.

#### 1.4 Structure

This research begins with an introduction to the classical aspects of Islamic economics and how products and services were conceptualised. It then goes further to examine how the Saudi financial market has evolved from its traditional system to new transformations and innovations. The study then went further to look at the theoretical aspects of market abuse that include the utility, right based arguments, level playing field, fiduciary duties as well as aspects that revolve around the theories of fairness and fraud. In subsequent parts, the research looks at the legal framework for the financial markets of the two jurisdictions i.e. Saudi and the UK. This leads to the exploration of



the role and responsibility of regulatory bodies in both jurisdictions. Furthermore, the research looks at the nature of enforcement of penalties for market violations and the procedure involved in both regimes. It concludes by making a concise but analytical exposé of all the questions and the debate contained in the body of the research as well as areas of recommendations and what is open for future research.

### 1.5 General Introduction

Scholarship has incessantly revealed how financial markets play a significant role on the economy of states and the world as a whole. To fulfil this role, financial markets are also expected to check against abuses. Evidence has shown that fraud, manipulation, and insider dealing remain significantly present in today's financial markets. Proper regulation is, therefore, a necessary element for the effective operation of financial markets and attracting investors.

Historically, financial markets have been victims of abusive and unethical practices, from market manipulation to others such as predatory lending where money is lent on security knowing that the debtor is likely to default and seeking to profit from that default on the realisation of securities.<sup>1</sup> While some of these practices do not necessarily qualify as market abuse, market manipulation appears to be among the prevalent incidents in financial markets. There had been continuous attempt in making regulatory reforms that will enhance transparency, accountability, trust and confidence in the market and among investors and participants is now more than ever.<sup>2</sup>

The main rationale behind the regulations against market abuse is to deter individuals or groups, who through their professional, official or a privileged position, use or misuse information to manipulate the market in order to accrue for themselves or proxies some gain to the detriment of others. Although some scholars pose a different claim that insider dealing sustains markets by promoting inflows of information, essential to an efficient stock market,<sup>3</sup> the most prevalent argument is that insider dealings and market manipulations have the tendency to affect the notion of trust and

---

<sup>1</sup> Squires, G. D. (2004). *Why the poor pay more: How to stop predatory lending*. Greenwood Publishing Group, p 2

<sup>2</sup> These include laws such as the EU Market Abuse Directive, 2003.

<sup>3</sup> Ashe, T.M. (1990). Insider Dealing. *Company Lawyer*, 11(7), 1-26.

brings about a great deal of undue advantage to a few while affecting the investment and capital of the majority of unsuspecting participants.<sup>4</sup>

One of the keys to determining the value of securities in the market under the ‘capital market hypothesis’ is the availability of information on the value of securities. This suggests that the value of companies’ securities directly corresponds with information available in the financial market.<sup>5</sup> Hence, if there is transparency of financial and other relevant information about the company publicly available then that will allow the market to properly establish that value. The invaluable nature of such information and the way in which they are obtained determines whether they were used in the appropriate manner or to perpetrate what may be regarded as market abuse.<sup>6</sup> Described generally as insider dealing and market manipulation, such acts are generally perceived as undermining the moral functionality and confidence in the market and have led to series of regulation in many countries.

In general, market abuse can come in many ways. The common characteristic of each is the individual or groups aim to exploit the market immorally and unlawfully for personal or institutional gain.<sup>7</sup> The most commonly referred types of market abuse are market manipulation and insider trading. These acts are targeted and sanctioned most municipal and international law as offences that are punishable. Depending on the jurisdiction, different legal frameworks are often present to deal with acts of market abuse.<sup>8</sup> In many cases, market abuse is aimed at either manipulating the value of a security on a financial market or altering the perceptions of its price and value, thereby altering the underlying view of market participants. This according to Dabbah is often achieved in two distinctive ways i.e. ‘Market-based manipulation and information-based manipulation.’<sup>9</sup> The former is mainly done in financial markets and mainly involves false and misleading information regarding the values, quantity or other related information about company securities such as volume and frequency of trading.

---

<sup>4</sup> McVea, H. (1995). What’s wrong with insider dealing? *Legal Studies*, 13(3), 390-406.

<sup>5</sup> Hannigan, B. (1994). *Insider Dealing*. 2nd Ed, Longman, London.

<sup>6</sup> The case of *Spector Photo Group C-45/08* See discussion in Jesper-Lau, H. (2009). What constitutes insider dealing? International and Comparative Corporate Law Journal, Forthcoming. [Available at SSRN: http://ssrn.com/abstract=1499093](http://ssrn.com/abstract=1499093)

<sup>7</sup> Minenna, M. (2003). The detection of market abuse on financial markets: *A quantitative approach*. *Quaderni di finanza*, (54).

<sup>8</sup> *ibid*

<sup>9</sup> Dabbah, M. M. (2007). *Competition Law and Policy in the Middle East*. Cambridge University Press.

The latter which is often referred to as insider trading, is the misuse of information to exploit the financial market when such information is not available to the public but known to the party due to certain privileges.<sup>10</sup> Rider *et al.*, defined insider dealing as trading in “price sensitive information gained through the insider’s special relationship with the company.”<sup>11</sup> Other scholars such as Mangelsdorf defined market manipulation as the act of “creating a false or misleading impression about financial instruments or their issuers by distorting the market, often by price manipulation.”<sup>12</sup> In reference to the Published in 2003, the EU Market Abuse Directive (MAD) published in 2003 to implement an EU-wide market abuse regime, the Directive also went on to define insider trading as any act of buying or selling financial instruments, or advising or instructing someone else to do so, when in possession of inside information.<sup>13</sup> For the purpose of this research, it is important to look at the statutory definition of insider trading under both the Saudi, UK and EU laws, and to also understand the nature and character of these definitions. Under MAD, insider dealing is the use of non-public information of a precise nature that would be likely to have a significant effect on the price of the relevant financial instruments.<sup>14</sup> The Market Abuse Regulation (MAR), which was published in 2014 expanded this definition to make it clear that inside dealing includes using such information that a reasonable investor would be likely to use as part of the basis of his investment decisions.<sup>15</sup>

The design and development of laws and regulatory framework of the modern financial markets are however influenced by various factors including the need to adapt to international best standards, which often are the dictates and extent required by leading global players in the financial markets. This is evident in the principles of the ‘most favoured nation clause’.<sup>16</sup> The United Kingdom (UK), which has one of the oldest

---

<sup>10</sup> Minenna, M. (2003). The detection of market abuse on financial markets: *A quantitative approach. Quaderni di finanza*, (54).

<sup>11</sup> Rider, A., and Linklater, L. (2002). *Market abuse and Insider dealing*. Butterworths, London.

<sup>12</sup> Mangelsdorf, A. (2005). The EU market abuse directive: Understanding the implications. *Journal of Investment Compliance*, 6(2), 30-37.

<sup>13</sup> Market Abuse Directive 2003/6/EC, also see Swan, E. (2004). Market Abuse: a new duty of fairness. *Company Lawyer*, 25(3) 67-68, p67.

<sup>14</sup> Commission Implementing Directive (EU) 2015/2395 of 17<sup>th</sup> December 2015.

<sup>15</sup> Market Abuse Regulation, (EU) No. 596/2014.

<sup>16</sup> See Thuen-Paulsen, T. K. (2016). Most Favoured Nation-Clauses; Schill, S. W. (2009). Multilateralizing investment treaties through most-favored-nation clauses. *Berkeley J. Int'l Law*, 27, 496.

known institutions of modern finance and banking, has been at the leading role of shaping and reforming the nature and character of financial market practices. It has also played a leading role in terms of the introduction of different products and services while developing the way contracts are implemented and designed among the various players in the market, setting limits and obligations upon parties and regulators.

In Saudi, one may argue that the Fifth Development Plan that began gathering momentum in 1984 and the concept of the Saudi Industrial Market were among the major aspects that saw the beginning of a more concerted effort for reform of the financial industry. The emphasis was to create an economy that is based on industry and not only reliant on oil. Similarly, the development of specialised credit institutions such as Saudi Industrial Development Bank (SIDB) also bolstered this drive. Although this was an approach different from the prior reliance on the oil boom, it still became clear that there is the need to develop beyond just credit from a single institution. This saw the engagement of professional stakeholders and for the first time, private sector played a significant role in the country's economy. The need also arose for significant capitalisation if the goal of industrialisation set was to be achieved. The first point of access to finance was the SIDB but that alone proved insufficient.

In general, the Saudi system had been one governed mainly by Shari'ah law. This has created a gap because the system had for years not developed clear financial laws and therefore the system has remained one that is mainly governed through general legal provisions. Paradoxically, the Kingdom was ambitious to join other nations in developing and opening its financial market to investors both within and internationally. This also includes the decision to join the World Trade Organisation (WTO). These ambitious policies necessitated far-reaching legal and institutional reforms some of which were negotiated in 2005 as part of the process to comply with being a member of the WTO.<sup>17</sup> This process includes numerous bilateral agreement signed into legally binding documents in line with the International Organization of Securities Commissions (IOSCO) standards. These decisions by Saudi were to fulfil its

---

<sup>17</sup> Dar, H and Azami, M. T. A. eds. (2011) '*Regulatory Issues: Challenges and Solutions*'. *Global Islamic Finance Report*. London: BMB Islamic UK Limited.

strategic commitments to expand its financial industry and tap from the opportunities that the global market offers.<sup>18</sup>

Remodelling what is seen as ineffective domestic regulations became an imperative for the Kingdom in its move to support capital market expansion.<sup>19</sup> The implication however is that, these proposals for reorganisation are modelled on a western paradigm especially in the legal aspects of rights and responsibilities of parties. Evidence however indicates, there were some legal proposals long before the WTO agreement i.e. the executive/enforcement law, the finance lease law, the real estate mortgage law, the real estate finance law and the law on supervision of finance companies.<sup>20</sup> What emerged after the WTO agreements generated ambiguity in the regulation of some financial products that are seen as transactions prohibited from an Islamic perspective. An example of these is the corporate insurance regulation, which lacks guidance as to what constitute corporate insurance.<sup>21</sup>

Notwithstanding the hindering factors, there appears to be an increasing domestic demand for Islamic financial products on one hand and the call to attract foreign investors on the other. For domestic investors, there is a peculiar challenge in the absence of well-established financial laws and guidance to deal with contracts such as *Takaful*, a common feature of Islamic finance that would be discussed in the later in part of this research.<sup>22</sup> Moreover, the effect of the absence of Shari'ah compliant products as well as mortgage laws are very profound in sectors such as real estate, where demand for owning houses by nationals through the western market model is very difficult due to protracted waiting list and wealth constraints. The way to remedy this according to observers is by enactment of mortgage laws capable of boosting the real estate market, diversify bank's balance sheet and propel opportunities for issuance of *Sukuk* bonds.<sup>23</sup> Doing this they argue will enhance the needed liquidity and boost the

---

<sup>18</sup> Malkawi, B. H. (2006). Anatomy of the Case of Arab Countries and the WTO. *Arab Law Quarterly*, 20, 2, 110-151, p1.

<sup>19</sup> Ramady, M. A. (2010). *The Saudi Arabian economy: Policies, achievements, and challenges*. Springer Science & Business Media. See also Kobayashi, Y. (2007). Corporate strategies of Saudi Aramco. *The James A Baker III Institute for Public Policy*, Rice University, Texas, US.

<sup>20</sup> Saudi Gazette (2012)

<sup>21</sup> Dar, H and Azami, M. T. A. eds. (2011) '*Regulatory Issues: Challenges and Solutions*'. *Global Islamic Finance Report*. London: BMB Islamic UK Limited.

<sup>22</sup> *ibid.*

<sup>23</sup> The concept of *Sukuk* bonds will be discussed in the subsequent chapters.

market to enable the issuance not only of different products but also of providing micro and macro credit as well as financing of mortgages and other market products.<sup>24</sup>

The absence of a well characterised financial market body and the non-integration of standards such as Accounting and Auditing Organisation for Islamic Financial Institution (AAOIFI), the Islamic *Fiqh* Academy (IFA) etc. left unfilled the legal gap that could have enabled the smooth operation of markets in relation to financial products. Similarly, the absence of diverse Shari'ah compliant products has reduced the willingness, especially for domestic investors to invest. In the banking sector for example, 60 – 80 per cent of transactions undertaken in Saudi Arabia retail and corporate banking are Shari'ah compliant products.<sup>25</sup>

### 1.6 Islamic economic principles

Islamic economic principles, which are the main regulatory framework upon which the Saudi capital market operates makes emphasis on the principles of Shari'ah that all transactions either of property or finances must be fair to all parties involved.<sup>26</sup> It also insists on the principle of commensurate share and equity that must be respected by all stakeholders in any financial or business dealing.<sup>27</sup> These principles have are generally invoked in designing Islamic finance. Even at the point of difference in opinion or interpretation of what is contained in Shari'ah, the terms 'equity' and 'fairness' remain at the epicentre of all discussions. This ideology is mainly at the centre of Muslims' understanding of socio-economic principles.

What causes divergence of opinion is mainly caused by the differences in the sources and hierarchy of Islamic law. While the Qur'an and Sunnah are the primary sources, other sources include the secondary sources of Ijtihad or personal reasoning which mainly depends on the intellectual capabilities of scholar. The primary sources address certain issues in general terms and often need interpretations and are capable of different interpretations. Mujtahid (scholars that do Ijtihad) are those with obligation to

---

<sup>24</sup> Wilson, R. (2004). *Overview of the sukuk market. Islamic Bonds: Your Guide to Issuing, Structuring and Investing in Sukuk*. Euromoney Books, London, 6-7.

<sup>25</sup> *ibid*.

<sup>26</sup> Lahsasna, A. (2013). *Maqasid Al-Shari'ah in Islamic Finance. Kuala Lumpur: Institute of Banking and Finance Malaysia*.

<sup>27</sup> El-Gamal, M. A. (2006). *Islamic finance: Law, economics, and practice*. Cambridge University Press.

take into consideration the effects of necessity, public interest and the needs of community, which together cause differences in interpretation and opinion.<sup>28</sup> Moreover, the influence of major Islamic schools of jurisprudence impact differently on Mujtahids.<sup>29</sup> For example, the emergence of the modern concept of *Tawarruq*<sup>30</sup> was first in Saudi Arabia, where the prevailing school is the Hanbali School of Islamic jurisprudence, which is also the only classical school that has explicitly approved this type of trading.<sup>31</sup> In *Tawarruq*, the buyer purchases a commodity from a seller on a deferred payment and the buyer sells the property immediately to a third party and raises the money he needs. This system is to avoid *Riba* in buying and selling. Yet, it is important to state that advent and growth of Islamic finances and new market products have necessitated resort to Ijtihad and the differing opinions and interpretations on compliance of contracts and products to the rules of Shari'ah.<sup>32</sup> In places like Malaysia for example, the Shafi'i School influences Ijtihad.<sup>33</sup>

Along these lines, regulators tasked with the responsibility of designing capital market regulations in Saudi and other Muslim nations have struggled to balance the demands of consumers, the choice for expansion beyond local markets and the need to comply with Shari'ah principles.<sup>34</sup> This becomes even more challenging as economic needs change and new products and services emerge. Hence, scholars of Islamic principles have continued the search for ways in which these products and services can be

---

<sup>28</sup> Kamali, Mohammaed Hashim (2000), *Principles of Islamic Jurisprudence*, Kuala Lumpur: Ilmiyyah Publishers, pp.367-370.

<sup>29</sup> Hallaq, W. B. (1986). On the Origins of the Controversy about the Existence of Mujtahids and the Gate of Ijtihad. *Studia Islamica*, 129-141.

<sup>30</sup> The concept of *Tawarruq* is an Islamic financial transaction where an individual (customer) buys an asset at a particular marked up price to be paid at a later date. The customer can then sell such property instantly to raise the capital he or she needs

<sup>31</sup> Siddiqi, M. N. (2007, February). Economics of *Tawarruq*: how its Mafasid overwhelm the Masalih. In *Tawarruq Seminar organised by the Harvard Islamic Finance Programme, at London School of Economics, London, UK on* (Vol. 1). See also Al-Amine, M.B.M. (2001), "The Islamic bond market: Possibilities and challenges", *International Journal of Islamic Financial Services*. (3),1.

<sup>32</sup> Al-Amine, M.B.M. (2001), "The Islamic bond market: Possibilities and challenges", *International Journal of Islamic Financial Services*, (3), 1. See also Hammad, Nazih (2007), "*Takyif Sharikatai al-Aqd wa Atharuhu fi Tatbiqat al-Sukuk wa al-Musharakah al-Mutanaqisah*", paper presented at the Fifth Shari'ah Conference organized by the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), February, Bahrain.

<sup>33</sup> Ibid.

<sup>34</sup> Wilson, R. (2013). The development of Islamic finance in the gulf cooperation council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146. See also Khatkhatay, M. H., and Nisar, S. (2007). Shari'ah compliant equity investments: An assessment of current screening norms. *Islamic Economic Studies*, 15(1), 47-76.

internalised without breaching the rules of Shari'ah.<sup>35</sup> For example, the Holy Prophet Muhammad (s.a.w) recommended that when one intends to exchange a commodity for another, he should sell his own commodity and use the proceeds to purchase the other instead of bartering in commodities that differ in quality.<sup>36</sup> This according to Sunna is to avoid the situation where one of the parties would feel he or she received unfair price or a deal that is not fair.<sup>37</sup> This suggests that when dealing with products, especially if it involves exchange instead of purchase, there is the need to ensure that the value (or quantity) of the product is proportionate to the one exchanged.<sup>38</sup> Jabeen and Khan, however<sup>39</sup> states that, what is striking about this ruling is the “weight of importance given to standardisation of commodities, an important concept of quality management. Injunctions against barter etc. were likely to have been contrary to normal practice and may well have been very novel ideas, at the time of the Prophet.

Another central point of this debate is the concept of Usury (Riba), which resonates in every discourse with Islamic finance.<sup>40</sup> This idea of lending for interest has engaged many researchers not only in the Islamic but also in conventional economics. Yet, one has to admit that, in today's global economics and finance, the business of lending is mainly that which involves interest. In Islamic finances however, the idea had been that in which the lender purchases from the market and sells it to the customer through which he or she makes profit for the sale. This system varies depending on the contract. It could be Murabahah, which is some form of ‘trust sell’ in which the seller purchases

---

<sup>35</sup> Sundararajan, V., and Errico, L. (2002). *Islamic financial institutions and products in the global financial system: Key issues in risk management and challenges ahead* (Vol. 2). International Monetary Fund.

<sup>36</sup> Rosly, S. A. (2005). *Critical issues on Islamic banking and financial markets: Islamic economics, banking and finance, investments, Takaful and Financial Planning*. Dinamas Publishing.

<sup>37</sup> Usmani, M. I. A., and Ansari, J. A. (2010). Meezan bank's guide to Islamic banking. *Research Journal Of The Institute Of Business Administration Karachi-Pakistan*, 5(1), 171.

<sup>38</sup> Uusmani, M. T., and Taqī 'Uṣmānī, M. (2002) discussed this aspect taking reference from hadith of the Holy Prophet, (SAW) contained in Bukhari, Kitab al-Buyu', Bab idha arada bay'a tamrin bi tamrin khayrun minhu; and also in Nasa'i narrated from Abu Sa'id and Abu Hurayrah (RA) “A man employed by the Prophet,(SAW) , in Khaybar brought for him janibs [dates of very fine quality]. Upon the Prophet's (SAW) asking him whether all the dates of Khaybar were such, the man replied that this was not the case and added that "they exchanged a sa' [a measure] of this kind for two or three [of the other kind]". The Prophet,(SAW) , replied, "Do not do so. Sell [the lower quality dates] for dirhams and then use the dirhams to buy janibs. [When dates are exchanged against dates] they should be equal in weight."

<sup>39</sup> Jabeen, Z., and Khan, M. R. (2008). An Inquiry into The Usage of Real Assets in Islamic Transactions and Their Benchmarking: The Implications for Islamic Capital Markets. *Islamic Capital Markets*, 69.

<sup>40</sup> Gavin, M., and Hausmann, R. (1996). The roots of banking crises: the macroeconomic context. See also, Everett, J., and Watson, J. (1998). Small business failure and external risk factors. *Small Business Economics*, 11(4), 371-390; Diamond, D. W., and Rajan, R. G. (2005). Liquidity shortages and banking crises. *The Journal of finance*, 60(2), 615-647.



an item from a seller at a specified profit margin payable to the seller,<sup>41</sup> or Musharaka, which is a return on equity kind of partnership in which parties involved contribute to towards the financing of a venture, share profits on a pre-agreed ratio and also losses according to each parties equity participation.<sup>42</sup> The third most common is Ijarah, which simply means a lease. In this type of contract, the intermediary, usually a bank purchases an asset and leases it to a client for fixed termly payments.<sup>43</sup> This may include an option for the lessee to buy the asset at the end of the lease. All of these transactions are similar to what is found in other global markets, the difference, however, is when it comes to outright interest (usury) that is prohibited as an essential condition in a contract.

Despite the fact that it has evolved, Islamic principles on the strict prohibition of Usury have not been modified. For example, religious leaders protested the recent IPO by National Commercial Bank (NCB) of \$6 billion offering of a total of 500 million shares with 300 million of those going to the public in the kingdom.<sup>44</sup> Despite the initial amount of interest in the IPO, the statement by the Kingdom's Grand Mufti that the IPO is forbidden under Islam, which bans usury has kept many people away.<sup>45</sup> NCB said it plans to become fully compliant with the regulations on usury over the next five years. Yet, it is evident that religious authorities were not convinced that is enough.<sup>46</sup> Islamic jurist are insistent that Islamic Finance is comprehensive and covers all business exchanges in which usury is seen not only as cheating, it is also considered a form of exploitation.

### 1.7 Saudi Arabia's ambition for a developed and open financial market system that converges with global standards

The optimism that pushed for most of the regulatory reforms towards today's Saudi financial market was largely due to the fact that, through reforms and enactments, authorities believe the existing Islamic financial services industry has the potential of

---

<sup>41</sup> Alsayyed, N. (2010). The uses and misuses of commodity murabaha: Islamic Economic Perspective.

<sup>42</sup> Smolo, E., and Kabir Hassan, M. (2011). The potentials of Musharakah mutanaqisah for Islamic housing finance. *International Journal of Islamic and Middle Eastern Finance and Management*, 4(3), 237-258.

<sup>43</sup> Rohmatunnisa, D. (2008). *Design of Ijarah Sukuk*. Unpublished MA in Finance and Investment, University of Nottingham, Nottingham, UK.

<sup>44</sup> See, <http://www.cnbc.com/id/102140240>.

<sup>45</sup> *ibid*.

<sup>46</sup> *Ibid*.

converge to modern governance practices. With a view to making capital markets attractive to both foreign and domestic investments, initiatives were made towards corporate governance in a way that will be significantly close to international standards. Essentially Shari'ah is the primary source of law; it is believed that the concepts of transparency, accountability and fiduciary responsibility in the context of Shari'ah can possibly work in developing a financial market system and regulation that will fulfil the needs and confidence of investors. For the development of an Islamic stock market, Islamic scholars are unanimous that transparency, the absence of insider trading and market manipulation are essential, and excessive exposure to financial risk is both immoral and unethical.<sup>47</sup>

Generally, the Islamic finance has always been aware of the need for the protection of the buyer, seller, borrower and lender from fraud and dubious behaviour and also allows the state to regulate these conducts and to adjudicate trade disputes. The principal area of divergence between Islamic law and secular legislation has always been the area of interest on investment. Hence, it is noteworthy that while convergence of Shari'ah principles to modern financial products and services is possible in the context of creating efficiency and accountability to financial market, aspects surrounding interest for investment are not likely to pass the Shari'ah validity test.

What the Saudi regime continued to work on was later to become legislation in 2000 called the Capital Market Law (CML), which is also the law that established the Capital Market Authority (CMA) as the regulatory body for financial markets in the country. Although bodies similar to the CMA unofficially began since the early fifties, it was the current CML, promulgated pursuant to Royal Decree No. M/30 of 2/6/1424AH, which formally brought the CMA into full implementation. This reform was seen as the first phenomenal financial market law that allows for convergence of the interest of the regime and the interest of investors. The CML is enforced through the CMA, which is a government organisation mandated with the role of applying and enforcing financial market regulations. The main goal was to create an investment environment that is

---

<sup>47</sup> Alhabshi, S. O. (1994, January). *Development of capital market under Islamic principles*. In Conference on Managing and Implementing Interest-Free Banking/Islamic Financial System, Kuala Lumpur.

attractive, secure and that which holds companies and individuals accountable for violation.

The role of the regulatory body is consolidated by quasi-judicial committees that have jurisdiction over disputes falling under the provisions of the CML. These are the Committee for the Resolution of Securities Disputes (CRSD) and the Appeal Committee for the Resolution of Securities Conflicts (ACRSC). The committees enforce rules and instructions issued by the CMA and the Saudi Stock Exchange with respect to both public and individual actions.

The general foundation of these reforms is to introduce a financial market system that would ensure transparency, prohibit insider dealing and deal with agency problems and ensure that agents act in the best interest of the principal. One of the arguments however is on the kind of model to adapt. One of the most debated issues was to introduce a system that U.S style securities market, which some argue is capable of triggering economic growth.<sup>48</sup> Opponents however argued against this proposal, highlighting “the distinct socio-economic and political features of each society that may not only resist the transplanted reforms but such features may also persist.”<sup>49</sup> They also pointed to the realities of deep-rooted local culture and its significance on any reform that is to be made on corporate governance.<sup>50</sup> Yet, the desire to transition from orthodox market structure to a modern system influenced the enactment of the provisions of the CML, including the idea to shift the jurisdiction of market disputes from conventional Shari’ah courts in Saudi to an institution solely dedicated for this purpose i.e. the CRSD. This is despite the concern that these types of convergence limit the chances of broader corporate evolution and may result in a system that is unbalanced and lacking certainty.<sup>51</sup>

Despite these concerns, the reform went ahead, based on the conviction that the future

---

<sup>48</sup> Paredes, T. A. (2003). Systems Approach to Corporate Governance Reform: Why Importing US Corporate Law Isn't the Answer. *A. Wm. & Mary L. Rev.*, 45, 1055.

<sup>49</sup> Ibrahim, A. A. (2006). Convergence of corporate governance and Islamic financial services industry: toward Islamic financial services securities market. *Georgetown Law Graduate Paper Series*, 3.

<sup>50</sup> Licht, A. N. (2000). The mother of all path dependencies: Toward a cross-cultural theory of corporate governance systems. *Available at SSRN 208489*.

<sup>51</sup> Gilson, R. J. (2001). Globalizing corporate governance: Convergence of form or function. *The American Journal of Comparative Law*, 329-357.

of the financial industry depends on global competitiveness, which can only be achieved through reforms, innovations and market regulations to deal with market abuse based on standardised global practices. This resulted in the development of institutions and regulatory frameworks. What is evident is that these reforms have changed the Saudi market and have opened up new opportunities for foreign investors.

## Chapter Two

### Developing market products and services through innovation and constraints

#### 2.1 Introductions

The global transformation of the financial market economy especially during the 1950s and 1960s is one that reshaped both the field of financial econometrics and regulatory endeavours of policy makers and officials in the financial market arena.<sup>52</sup> In particular, the globalisation of various industries since the 1980s was indicative of a deeper business and financial interconnectivity as well as across nations. As much as this commercial and economic renaissance brought about gains across borders, it also came with challenges of competition and regulation. Nations and institutions continued to find a way for cohesion, healthy competition and a coherent system that can guarantee the safety of investment as well as robust dispute resolution mechanisms. One of the challenges that became imminent is the one involving financial markets, which has become more sophisticated, more complex and even more vulnerable to abuses and manipulation. The interconnectivity of these financial institutions across borders as well as their interdependence reveal even a deeper need for a consolidated framework especially in terms of regulations and policing of financial dealings that affect various companies and investors cutting across different borders. While regimes continue to deal with these challenges, they also continue to benefit from the kind of diverse opportunities that financial markets bring. The enormous amount of investment in this sector has boosted economies and allowed for diversification in different kinds of products and services.

These challenges and advantages do not affect some nations as they do others. Developed economies in Europe and the Americas continue to benefit enormously from capital market industries. In others such as Saudi and many gulf nations where trades and investment are mainly built on Islamic principles, the need arises to explore ways to open up their markets to diverse investment both from within and from foreign investors. This has necessitated regimes such as in the Kingdom of Saudi Arabia which look outward to a future in which they can adapt to some of the overarching global system of finance markets and benefit from such diversification. To access this

---

<sup>52</sup> Easton, G. (2002). Marketing: a critical realist approach. *Journal of business research*, 55(2), 103-109, p103.

opportunity, they were compelled not only to establish a strong and attractive financial market but to also introduce regulatory frameworks that would ensure safety of investment and deal with issues such as dispute resolution and market abuse to a standard that would be acceptable to investors. These are known incentives that must be put in place in order to attract investment and also connect the domestic market with bigger markets across different nations.<sup>53</sup>

The challenge however is that, despite the quest to open up the market for emerging and innovative products and services, there is also the desire to preserve distinctive Shari'ah principles regarding finances and market transactions. This has, on many occasions, sparked enormous debate over when convergence and harmonisation might be taken too far.<sup>54</sup> Yet, what many instances revealed was the willingness of Islamic financial institutions to manifest the legitimacy of their interest while drawing closer to prevailing movements toward standardisation and global corporate governance.<sup>55</sup>

In particular, the question this part raises is on the issues relating to the extent and limits of how Islamic financial institutions become embedded in the wider framework of financial practices across the world.

This chapter intends to explore the nature and dynamics of the various finances in a system influenced by Islamic principles and approach of Shari'ah scholars and economist on financial market products these products can be replicated in conventional markets that is open and attractive to investors in other parts of the world. The chapter would also look at the challenges of compatibility with conventional western financial systems and products and how this has brought new challenges but also open the ways for harmonisation towards new opportunities. This would lead to discussions on the features of Islamic financial instruments and how they relate to some existing western financial instruments. Attempts would also be made to discuss issues in light of the contemporary developments and challenges with regards to Islamic market expansion and the concept of alternative products and futures that are capable of forming the future of the Saudi market without breaching the fundamental tenets of

---

<sup>53</sup> El Qorchi, M. (2005). Islamic finance gears up. *Finance and Development*, 42(4), 46.

<sup>54</sup> Ibid.

<sup>55</sup> Ibid.

Shari'ah.

## 2.2 Developing Islamic financial market amidst systemic constraints

The question of efficient financial markets in the contemporary global financial system has taken many standpoints among the mainstream perspectives, which have argued either for robust official regulations or for a freedom that should allow the market system to regulate itself.<sup>56</sup> In the context of Islamic law, the need for regulation of the economic activities including and financial markets is also the subject of debate, with conditions articulated based on the ensuing event of any particular market transaction. Bianchi argues that the development of Islamic financial systems represents a revival and re-adaptation of Shari'ah principles along a broad spectrum of culture and politics, and a potential bridge across gaps that have historically divided the Muslim world from other civilisations.<sup>57</sup> In International comparative law, discourse on Islamic finance has essentially been a field of research driven by legal and religious pluralism, and the cross-fertilization of different legal traditions, both Western and non-Western.<sup>58</sup> Hence, it stands at the intersections of law and economics and of Religion and politics.<sup>59</sup> Within the larger framework, one witnesses an International financial regime that is evolving and often dominated by financial regulatory guidelines of the more industrialised nations of Europe and North America.<sup>60</sup>

Often, Islamic financial institutions have operated under legal frameworks that are consonant with Shari'ah principles. It has been seen that the Islamic financial markets flourish globally, within its limits, for more than a quarter of a century, gaining some success and also facing certain challenges. In the over 75 countries where Islamic finances are present, they account for about \$300 billion in annual growth,<sup>61</sup> with recent

---

<sup>56</sup> Rothband, M. N. (2008), 'Free Market'. *The Concise Encyclopaedia of Economic*. <<http://www.econlib.org/library/Enc/FreeMarket.html>> (Accessed on: 29/06/13)

<sup>57</sup> Bianchi, R. R. (2006). Revolution in Islamic Finance. *The Chicago Journal of International Law*, 7, 569-580.

<sup>58</sup> Dupret, B., Berger, M., and Al-Zwaini, L. (Eds.). (1999). *Legal pluralism in the Arab world* (Vol. 18). BRILL.

<sup>59</sup> Bianchi, R. R. (2006). Revolution in Islamic Finance. *The Chicago Journal of International Law*, 7, 569-580.

<sup>60</sup> Underdal, A., and Young, O. R. (Eds.). (2004). *Regime consequences: methodological challenges and research strategies*. Springer.

<sup>61</sup> Chong, B. S., and Liu, M. H. (2009). Islamic banking: interest-free or interest-based? *Pacific-Basin Finance Journal*, 17(1), 125-144

report valuing them at the excess \$1 trillion.<sup>62</sup> These challenges become even more obvious in the contemporary global market structure which prompts financial markets in the Islamic world to attempt a wide range of innovations and harmonisation in order to adapt to ever expanding markets around the world, while keeping to the fundamental rules of Shari'ah. What is obvious is that, over the last decade, Islamic finance, especially Islamic banking, has experienced global growth rates of 10-15 per cent per annum, and has been moving into an increasing number of western financial systems at an unprecedented pace where Islamic financial institutions are now present in over 51 countries.<sup>63</sup> Despite this consistent growth, there is still much left to be discussed in research and scholarship on the process by which the larger framework of Islamic finance were reformed and designed to work within a Western system, especially when it comes to the different products, services and regulations in financial market. But as Iqbal *et al.*, argue, the lack of robust institutional support had continued to hinder this objective for expansion of the market.<sup>64</sup> Developing an institutional set-up that would grow the market and open it to investors at home and abroad is one challenge that the Saudi capital market struggled with for decades. But as will be discussed later in chapter five, the last decade has seen a number of functional and robust regulations been established. These measure have modified the system and brought in innovations and rules that helped in opening the market to many products and investors.

While these developments and expansion were expected to take into account Islamic regulations, scholars argue that transactions in banking and company laws in most Islamic countries are increasingly becoming fashioned on the Western pattern<sup>65</sup> Those laws contain provisions that narrow the scope of activities. Parties can structure their agreements according to an Islamic contract; the enforcement of those agreements in courts may require extra effort and costs.<sup>66</sup> Hence, the reforms came to include special initiatives and laws for the introduction and practice of Islamic banking, capital markets etc. Such laws eventually came to facilitate the operation of these institutions. Scholars maintained that the main reasons for these regulatory regimes were to make the market

---

<sup>62</sup> Financial Times Special Report: The Future of Islamic Finance, December 14, 2010.

<sup>63</sup> Sole, J. A. (2007). Introducing Islamic banks into western banking systems. *IMF Working Papers*, 1-26.

<sup>64</sup> Iqbal, Zamir and Abbas Mirakhor, 2007, *An Introduction to Islamic Finance: Theory and Practice*. John Wiley and Sons, Pte. Ltd.

<sup>65</sup> Ibid

<sup>66</sup> Ibid



attractive, protect investors, check and supervise companies as well as to improve control of monetary policy. In the case of Islamic banks, there is an additional dimension of supervision, which relates to Shari'ah supervision, regarded as imperative for the safety of deposits and investments.<sup>67</sup> In many instances, the prudential supervision desirable in Islamic finances is similar to those of western financial markets, which is to ensure and maintain financial stability by demanding safety in the system.<sup>68</sup> But because Islamic regulations are relatively unwilling to allow very complex and unclear financial products and services and do not often take the kinds of risks that western financial institutions take, they are often less susceptible to vulnerabilities of their western counterparts. For example, the 2008-2009 financial crisis reveals that most Islamic banks suffered less and remained resilient to the effect of the crisis.<sup>69</sup>

As markets continue to grow in the midst of many reforms and challenges, scholars have continued to observe and debate on these numerous changes in both markets in the west and those in the Islamic world, such as Saudi. Some scholars have continued to point out to defects in the recommendations.<sup>70</sup> They pointed to the lack of viability for more risk-sensitive capital ratios, especially taking into account the importance of risk mitigation techniques and emphasising supervision and market discipline.<sup>71</sup> The Basel III Accord,<sup>72</sup> for example, came with a major principle i.e., a mandatory 'capital conservation buffer', equivalent to 2.5 percent of risk-weighted assets and also banks are mandated to hold a total of 7% CET1 capital.<sup>73</sup> This serves as a significant element, "to deal with pro-cyclicality through dynamic provisioning based on expected losses."<sup>74</sup>

---

<sup>67</sup> Ibid

<sup>68</sup> Errico, M. L., and Farahbaksh, M. M. (1998). *Islamic banking: issues in prudential regulations and supervision*. International Monetary Fund.

<sup>69</sup> In a report by Prof. Rodney Wilson of the London School of Economics, in May 2009, he points out that "Islamic banks have been less adversely affected than the major international banks by the 2008-9 crisis, making them more attractive to investors." See, <http://www.lse.ac.uk/newsAndMedia/news/archives/2009/05/IslamicBanking.aspx>.

<sup>70</sup> Caouette, J. B., Altman, E. I., and Narayanan, P. (1998). *Managing credit risk: the next great financial challenge* (Vol. 2). John Wiley and Sons.

<sup>71</sup> Barth, J. R., Caprio, G., and Levine, R. (2004). Bank regulation and supervision: what works best?. *Journal of Financial intermediation*, 13 (2), 205-248.

Danielsson, J., Embrechts, P., Goodhart, C., Keating, C., Muennich, F., Renault, O., and Shin, H. S. (2001). An academic response to Basel II.

<sup>72</sup> See <http://www.bis.org/bcbs/basel3.htm>

<sup>73</sup> Blundell-Wignall, A., & Atkinson, P. (2010). Thinking beyond Basel III. *OECD Journal: Financial Market Trends*, 2010(1), 9-33.

<sup>74</sup> Basel II. See also, Lindblom, T., Sjögren, S., and Willeson, M. (2014). *Financial systems, markets and institutional changes*. Palgrave Macmillan.

Some scholars argue that Basel III has “not properly address the most fundamental regulatory problem that the "promises" that make up any financial system are not treated equally.”<sup>75</sup> They also maintained that existing risk models treat risk as a fixed exogenous phenomenon, when in reality the market could be volatile based on both internal and external forces.<sup>76</sup> For example, markets can become volatile due to mergers and acquisition, collapse of a big company or some external factors such as natural disasters, war etc.

Blundell-Wignall and Atkinson also raised issues regarding risk-weighting approach of markets, which they say encourages portfolio concentrations in low-weighted assets e.g., government bonds and mortgages are incentives to capital as they expand businesses into lower-weighted areas.<sup>77</sup> But as Le Leslie and Avramova argue, some banks, regulators and market participants have doubts about the adequacy, transparency and even the comparability of capital.<sup>78</sup> They further pointed that this lack of trust as to the reliability of risk weighted assets reported by banks could have a number of consequences i.e. making market participants re-calculate banks' capital ratios and disregard regulatory reported ratios. Assuming a lender can assess risk effectively, they may require higher capital ratios to compensate for the low perceived reliability of the denominator or they could stop using risk-based capital ratios altogether and turn to the leverage ratio, or even restrict lending to banks for which they have doubts about reported capital adequacy. This approach however evolved at the same time as did the market for credit default swaps, (CDS)<sup>79</sup> and contract for differences (CFD), which essentially created the potential for complete markets in credit and banks had the leverage to transform risks with derivatives without having to trade much securities on

---

<sup>75</sup> Blundell-Wignall, A., & Atkinson, P. (2010). Thinking beyond Basel III. *OECD Journal: Financial Market Trends*, 2010(1), 9-33.

<sup>76</sup> Danielsson, J., Embrechts, P., Goodhart, C., Keating, C., Muennich, F., Renault, O., and Shin, H. S. (2001). An academic response to Basel II.

<sup>77</sup> Blundell-Wignall, A., and Atkinson, P. (2010). Thinking beyond Basel III: Necessary solutions for capital and liquidity. *OECD Journal: Financial Market Trends*, 2010(1), 1-23

<sup>78</sup> Le Leslé, V., and Avramova, S. Y. (2012). Revisiting risk-weighted assets. SSRN: <http://ssrn.com/abstract=2050263>

<sup>79</sup> A credit default swap is a type of swap designed to transfer the credit exposure of fixed income products between two or more parties. Essentially, in a credit default swap, the buyer of the swap makes payments to the swap's seller up until the maturity date of a contract. In return, the seller agrees that, in the event that the debt issue default or experiences another credit event, the seller will pay the buyer the security's premium as well all interest payments that would have been paid between that time and the security's maturity date. See for example, <http://www.investopedia.com/terms/c/creditdefaultswap.asp>

primary markets.<sup>80</sup> Essentially, what risk transformations connotes is the idea where intermediaries offer low-risk securities to primary investors in order to attract funds. These funds are then used to purchase higher-risk securities issued by the ultimate borrowers.<sup>81</sup> What this does according to some scholars is that it undermines the fundamental idea of capital weights, as it favours assets with low-risk weights.<sup>82</sup> Although the new Basel III, seemed to have made enormous improvements with regards to some aspects of the capital management process under the Basel II, it still appears not to address the fundamental problems of the risk-weighting approach, which essentially is now part of the ongoing discussions on Basel IV.<sup>83</sup> This problem of offering low-risk securities and using the fund to buy high-risk securities contradicts the idea of transparency in the information available to the market. This may certainly lead to market abuse.

The endorsement of Basel III for example was seen by some scholars as a critical step in the process of strengthening the capital rules by which banks are required to operate.<sup>84</sup> It will, they argue, have considerably significance in reducing the probability and severity of a crisis in the financial sector, thereby reducing the potential for global financial stability.<sup>85</sup> Others however contend that many of the fundamental concerns were not properly addressed even with the successive implementation of the Basel Accords. These issues include those concerned with the general modelling of the Basel framework, issues surrounding regulatory and tax arbitrage and those issues to do with the need for more capital.<sup>86</sup> Thus, these challenges have paved the way for Islamic legal theorists and jurists to buttress their position for a more pluralistic perspective against mono-models, especially given the multiculturalism in contemporary societies as well as the globalisation of financial system. This entails the need to revisit some of the principles of the Islamic financial model as a means of collaborating and rebalancing

---

<sup>80</sup> Blundell-Wignall, A., and Atkinson, P. (2010). Thinking beyond Basel III: Necessary solutions for capital and liquidity. *OECD Journal: Financial Market Trends*, 2010(1), 1-23

<sup>81</sup> Reardon, T., and Timmer, C. P. (2007). Transformation of markets for agricultural output in developing countries since 1950: How has thinking changed?. *Handbook of agricultural economics*, 3, 2807-2855.

<sup>82</sup> Blundell-Wignall, A., and Atkinson, P. (2010). Thinking beyond Basel III: Necessary solutions for capital and liquidity. *OECD Journal: Financial Market Trends*, 2010(1), 1-23

<sup>83</sup> Ibid.

<sup>84</sup> Hannoun, H. (2010). The Basel III capital framework: a decisive breakthrough. *discurso pronunciado en el seminario de alto nivel BoJ-BIS Financial Regulatory Reform: Implications for Asia and the Pacific*, [www.bis.org/speeches/sp101125a.pdf](http://www.bis.org/speeches/sp101125a.pdf).

<sup>85</sup> Ibid

<sup>86</sup> Blundell-Wignall, A., and Atkinson, P. (2010). Thinking beyond Basel III: Necessary solutions for capital and liquidity. *OECD Journal: Financial Market Trends*, 2010(1), 1-23

the structural fragility of the market. Some scholars for instance argue that the state must play an active role in defining and guiding financial markets.<sup>87</sup> For example, Stiglitz argues that in some of the growing economies of East Asia, governments have taken a centre stage in both the creation and regulation, and in even in directing credit, both in ways that enhance the stability of the economy and the solvency of the financial institutions.<sup>88</sup> This they argue has ensured prospect, confidence and security.<sup>89</sup>

Although the Saudis and other Islamic countries did not go to the extent of having such robust debate as their European counterparts, scholars of Islamic finance rose up to point at the negative and overwhelming effect of a financial system that approves of excessive and imprudent lending by banks as the major cause of most financial collapses.<sup>90</sup> Hence, in their capacity and influence within the social and political institutions of these Islamic countries, they proposed that financial institutions and activities in capital markets must be regulated by state agencies to ensure that imprudent and excessive transactions are avoided.

The most fundamental questions however are, what encourages banks to engage in this imprudent repetition of risky practices, and how does strict government regulations work side by side with the idea of a liberal market? In relation to this, scholars such as Ahmed identified some of the main causes.<sup>91</sup> The first he said is inadequate market discipline in the financial system and the second is the enormous expansion in the size of derivatives, particularly Credit Default Swaps (CDSs).<sup>92</sup> There are, however, other issues related to this, which include the failure of those accepting CDSs to appreciate the risk from the insurers issuing them, and also given the active trading of CDSs, it sometimes becomes difficult to identify the actual counterparty legally responsible for compensating a bank if an ‘insured’ security failed, causing some bank counterparties

---

<sup>87</sup> Wade, R. (1990). *Governing the market: Economic theory and the role of government in East Asian industrialization*. Princeton University Press.

<sup>88</sup> Stiglitz, J. E. (1993). The role of the state in financial markets (Vol. 21). Institute of Economics, Academia Sinica.p23.

<sup>89</sup> Ibid.

<sup>90</sup> Ahmed, A. (2010). Global financial crisis: an Islamic finance perspective. *International Journal of Islamic and Middle Eastern Finance and Management*, 3, 4, 306-320.

<sup>91</sup> Ibid.

<sup>92</sup> Ibid.

to develop massive exposures to CDS risk.<sup>93</sup> This difficulty also arises because CDS were generally sold as Over-The-Counter Market (OTC)<sup>94</sup> rather than through a regulated market so there is the risk which is uncontrolled through regulated markets.

Another point of interest to scholars in the west and those of Islamic finance is in relation to the subprime mortgage crisis in the United States which was seen to be caused by the mixing of prime and subprime debt, paving the way for mortgage originators to pass the counterparty risk to even subprime debt to the purchasers, who would have ordinarily been reluctant to accept such risk.<sup>95</sup> Although the risk may have passed to the counterparty, they still may have the benefit of the CDS so the risk passes to the CDS originator. This type of complexity in partnership is disallowed under Shari'ah because it does not involve clear risk sharing. Instead, it shifts to one party or the other. Most fundamentally, when contracts are in form of mortgage that involves Riba, Islamic law frowns at it. Yet, Islamic scholars are aware of the changes sweeping the Islamic capital market and the way western products are modified to suit Islamic principles. Hence, they were quick to lend their voices to the principle that Islam financial system has to adhere to the core principle that ensures the financier and the entrepreneur equitably share the profit as well as the loss "no risk, no gain."<sup>96</sup> They argued that only then would unhealthy lending practices be avoided, and also the attitude of financiers that may produce some relatively safer financial system can be ascertained.<sup>97</sup>

Another key elements, which is one that has remained old and unchanged in defining the various aspects of operations, products, and service delivery in Islamic markets and finances is the clear and unequivocal prohibition of interest.<sup>98</sup> This is mainly interpreted within the juristic context on the understanding that the financial system has to be

---

<sup>93</sup> Levine, R. (2012). The governance of financial regulation: reform lessons from the recent crisis. *International Review of Finance*, 12(1), 39-56.

<sup>94</sup> Over-The-Counter Market is a kind of market where that is decentralised; has no central location and trading between participants is often done through communication modes such as electronic trading.

<sup>95</sup> Ahmed, A. (2010). Global financial crisis: an Islamic finance perspective. *International Journal of Islamic and Middle Eastern Finance and Management*, 3, 4, 306-320, p315.

<sup>96</sup> Ibid.

<sup>97</sup> Ibid.

<sup>98</sup> Warde, I. (2010). *Islamic finance in the global economy*. Edinburgh University Press.

“asset based”, and that money cannot be used as a means of gain through interest.<sup>99</sup> Perhaps the principle allows for secured lending operations to finance the purchase of real commodity.<sup>100</sup>

As the appeal for a pluralistic model is seen to be desirable, other concerns raised by professionals and scholars include the question of common denominators to formulate such a model. This desirability will hinge on the feasibility of these propositions, which suggest the complementarity of regulatory regimes, especially on issues relating to market abuses. On the other hand, there is another proposition as to the aspect of regulation relating to financial market products and services per se. The question raised here that eluded most secular approaches is the principles that the structure of the products and services of financial institutions must be sold to customers with the maximum level of transparency. In a study by Howcroft *et al.*, it was revealed that majority of customers lacked confidence in their ability to choose ‘good’ financial products due to lack of transparent information about products.<sup>101</sup>

The debate on harmonisation also reflects on the importance of ‘legal origins’ of countries’ laws.<sup>102</sup> Specifically, commercial transactions and the questions of private ownership rights have influence in the way each regime approaches the development of its financial market system. Legal theories, for instance, emphasise two interrelated channels through which legal origin influences finance.<sup>103</sup> The first contention is that while the protection of private contracting rights forms the basis of financial development, legal traditions differ in terms of the priority they assign to ownership of private property versus the rights of the state.<sup>104</sup> Although the world seemed to be drifting more towards a convergent regulatory regime, what many legal scholars agree on is that a system that accepts jurisprudence and allows judges to give interpretations

---

<sup>99</sup> Ibid. Also, this position is clear in the Holy Qur’an 3:39 and 4: 161 among others.

<sup>100</sup> Ahmed, A. (2010). Global financial crisis: an Islamic finance perspective. *International Journal of Islamic and Middle Eastern Finance and Management*, 3, 4, 306-320, p315, p311.

<sup>101</sup> Howcroft, et al. (2007). Customer involvement and interaction in retail banking: an examination of risk and confidence in the purchase of financial products. *Journal of Services Marketing*, 21(7), 481-491, p488.

<sup>102</sup> Beck, T., Demirguc-Kunt, A. and Levine, R (2002) ‘Law and Finance: Why Does Legal Origin Matter? *NEBER Working Paper No. 9379, JEL No. G2, K2, K4, O16, P5*. See, <http://www.nber.org/papers/w9379.pdf>. 1

<sup>103</sup> Ibid.

<sup>104</sup> La Porta et al. (2002). Investor protection and corporate valuation. *Journal of finance*, 1147-1170.

of laws in terms of efficiency and transparency is more likely to produce a lucid and clear systemic framework than the one which does not.<sup>105</sup>

Yet, one needs to understand the trajectories of contemporary financial markets, formal or informal, as vehicles for allocating capital and also risk,<sup>106</sup> and whose efficiency lies in transnational coherency, transparency and connectivity of institutions and investors moving across state boundaries.<sup>107</sup> Understanding financial markets from this perspective, i.e., agents, lenders and intermediaries and efficient secondary market prices, market products etc. are aspects that can hardly be determined through some unilateral municipal legislations.<sup>108</sup> Hence, regulatory regimes are seen as the best emerging concept.<sup>109</sup> Thus, from the broader understanding of these contending perspectives on the legal personality of financial markets, the incompleteness of municipal laws and indeed the importance of a stable global financial markets are major issues to be considered in examining the feasibility of a pluralist approach to law enforcement regime.

In the remainder of this part, this study will further examine the questions briefly highlighted above by shedding more light on issues such as the nature of Islamic law enforcement approach in financial market regulation. This will include its legal products, its principles, objectives and the challenges facing the Islamic approach. Similarly, to understand the differences of legal origins between the Saudi Capital Market Authority and UK's Financial Conduct Authority (FCA), this study will examine the nature of UK's law and the principles that structured the financial market products and services in order to drawn comparisons. As comparative analysis, this study is aimed to establish a pluralist approach for regulatory regime that effectively enforces laws that stabilises the financial market and deters abuses and ensures the transparency in financial transactions are accorded to the market participants. Thus, the need to discern the regulatory imperatives of financial markets products and services

---

<sup>105</sup> Rubin, P. H. (1982) Common law and statute law. *Journal of Legal Studies*, 11, 2, 205-233; Bailey, M. J., and Rubin, P. H. (1994). A positive theory of legal change. *International Review of Law and Economics*, 14, 4, 467-477.

<sup>106</sup> Wurgler, J (2000) 'Financial Markets and Allocation of Capital. In: *Journal of Financial Economics*, vol. 58, p. 188

<sup>107</sup> Jackson, H. E., and Roe, M. J. (2009). Public and private enforcement of securities laws: Resource-based evidence. *Journal of Financial Economics*, 93(2), 207-238.

<sup>108</sup> *Ibid*

<sup>109</sup> Levich, R. M. (2001). *International financial markets*. McGraw-Hill/Irwin.

should not overlook the role of government intervention in examining the problems related to the mood of financing the financial markets products and services and the nature of the laws binding the transactions.

### 2.3 Innovations and harmonisation

Generally, the ambition for a robust financial market is to encourage and supports growth of big and small industries and to allow small and large fund traders to take advantage of trading in stocks and commodities. This initiative where people with small capital can now find ways to trade while institutions also invest in goods and services has seen the global development and sophistication of the financial market. But beyond development in various sovereign frontiers, there is also the integration of markets, which allows people to trade in commodities within and outside their national or local constituencies. What integration does essentially is to complement growth and also to enhance regulation and dispute resolution while supporting the financial and economic infrastructure of nations.

As Simmons argues in his work, the globalisation of capital markets has complicated the tasks of national financial regulators by increasingly making it difficult to regulate the broad range of transactions by banking and securities firms on a national level.<sup>110</sup> Hence, several factors come into play to influence how markets connect and work, which include institutional arrangements, market pressure and even political pressure.<sup>111</sup> For systems like Saudi Arabia, one of the main challenges is whether they can acquire the incentives to emulate the regulatory frameworks of mature markets like the United Kingdom, and whether the dominant financial markets experience negative externalities in the process.<sup>112</sup>

Putting up a financial market system that has the incentives of reaching international standards and attracting large amount of foreign investment has been a challenge for systems like Saudi Arabia where finances are regulated by rules that are embedded in the principles of Shari'ah law. Opening the market to international participants is

---

<sup>110</sup> Simmons, B. A. (2001). The international politics of harmonization: the case of capital market regulation. *International Organization*, 55(03), 589-620.

<sup>111</sup> Ibid

<sup>112</sup> Ibid.



challenged by this inherent structure of the system. The continued and future success of the Saudi industry is therefore dependent on many variables, which include reforming the regulatory framework to meet international standards and also ensure that some of the inherent principles of Shari'ah are present to attract local participants. This according to Vogel and Hayes it appears inevitable and requires “ambitious innovation.”<sup>113</sup> These have to include the development of clear laws and initiatives to include “developing doctrines governing the creation and regulation of an Islamic public financial market.”<sup>114</sup> This need for standardisation is seen to be an essential part of any framework.

In April 2015, the Saudi Capital Market Authority announced its intention to open the Saudi capital market (Tawadul) to qualified foreign institutional investors and state rules guiding the market.<sup>115</sup> The Saudi Arabian stock market capitalisation is projected be around \$528bn.<sup>116</sup> This is marginally larger than all the Gulf Cooperation Council (GCC) stock markets combined. As Khalid Al-Rabiah, chairman of Tadawul, stated, the goal of the Tadawul is not only about the local market but also a move to attract foreign investment.<sup>117</sup> Jan Dehn, head of research at Ashmore added, “Saudi Arabia is a very large, liquid market. It will potentially be the seventh largest Emerging Markets (EM) equity market-by-market capitalisation, which places it just behind South Africa (\$543bn), but ahead of Russia, Malaysia, Mexico and Indonesia. The Tadawul trades on average \$2.4bn per day across 162 listed companies and offers a rich selection of opportunities ranging from banks to consumer-driven businesses.”<sup>118</sup>

The main points of this release by the Saudi authorities stress that qualified foreign institutions wanting to participate in the Saudi financial market must have a minimum \$5bn in assets under management and have been operational for a minimum of five years. This, observers think, is a good move by the Saudi market regulators in their

---

<sup>113</sup> Vogel, F. E., and Hayes, S. L. (1998). *Islamic law and finance: religion, risk, and return* (Vol. 16). Brill. P293

<sup>114</sup> Ibrahim, A. A. (2006). Convergence of corporate governance and Islamic financial services industry: toward Islamic financial services securities market. *Georgetown Law Graduate Paper Series*, 3. p7

<sup>115</sup> Martin M. (2015) Will the Tadawul's opening be a turning point for Saudi's economy? See, <http://gulfbusiness.com/2015/06/will-tadawul-opening-turning-point-saudis-economy/#.VZBIy-fwPV0>

<sup>116</sup> See, <http://www.ftsglobalmarkets.com/issues/issue-81-march-april-2015/the-long-awaited-opening-of-the-saudi-stock-market-to-foreign-investors.html>

<sup>117</sup> See, <http://www.arabnews.com/news/735921>

<sup>118</sup> John S. (2015) is Middle East Director based in Riyadh for the Ashmore Group. See, <http://www.arabnews.com/columns/news/761561>

attempt to diversify and reach out to international markets and investors, especially with the fall in price of oil.<sup>119</sup>

However, the need to expand the market is also challenged by other significant issues that are rooted in Islamic principles that define most of the economic regulations of the Saudi capital market. Economics and regulatory bodies that determine the regulations for Saudi and other Islamic economies understand the influence played by Shari'ah principles in guiding transactions and in shaping the system and its rules.<sup>120</sup> Through its history, the Saudi market is influenced largely by these regulations as contained in Islamic principles. In particular, aspects to do with the prohibition of relation to usury, and contracts that have the tendency of replicating the character of gambling or speculation.<sup>121</sup> In line with these principles which are embedded in Shari'ah, officials were able to draw a framework for products and services they consider do not violate these principles.<sup>122</sup> But as the industry is poised to reach out to international investors and markets, challenges arise as to how the system will adapt into the larger framework of international finances.<sup>123</sup> What further adds to this challenge is the familiar divergence of opinion among scholars as a result of different interpretations.<sup>124</sup> Hence, the question of harmonisation and standardisation of these regulations become even more imminent as the industry expands beyond its traditional jurisdiction of Islamic countries.

## 2.4 Challenges of Shari'ah compliance

As the Saudi capital market advances, the issue of compliance with Shari'ah and adapting to conventional models has been a subject of interest, especially in recent times.<sup>125</sup> The Saudi Stock Market also has mutual funds that are equally Shari'ah

---

<sup>119</sup> See, <http://www.ftsglobalmarkets.com/issues/issue-81-march-april-2015/the-long-awaited-opening-of-the-saudi-stock-market-to-foreign-investors.html#sthash.bcVACARn.dpuf>

<sup>120</sup> McMillen, M. J. (2006). Islamic capital markets: developments and issues. *Capital Markets Law Journal*, 1(2), 136-172.

<sup>121</sup> Al-Salem, F. H. (2009). Islamic financial product innovation. *International Journal of Islamic and Middle Eastern Finance and Management*, 2(3), 187-200.

<sup>122</sup> Hoepner, A. G., Rammal, H. G., and Rezec, M. (2011). Islamic mutual funds' financial performance and international investment style: Evidence from 20 countries. *The European Journal of Finance*, 17(9-10), 829-850.

<sup>123</sup> Aroui, M. E. H., and Rault, C. (2012). Oil prices and stock markets in GCC countries: empirical evidence from panel analysis. *International Journal of Finance and Economics*, 17(3), 242-253.

<sup>124</sup> Muneeza, A., and Hassan, R. The Legal Conflicts in Shari'ah Corporate Governance of Islamic Financial Institutions in Malaysia.

<sup>125</sup> Sole, M. J., and Jobst, A. (2012). *Operative Principles of Islamic Derivatives: Towards a Coherent Theory* (No. 12-63). International Monetary Fund.

compliant.<sup>126</sup> But questions of risk and return are among the challenges of not only conventional economics; it is also a question that challenges issues of investment and Shari'ah compliance under Islamic economics.<sup>127</sup> Yet, over the last two decades, there had been a growth in interest on Islamic finance and capital market. This is largely due to the growth of the industry, especially in the gulf nations. And globally, the size of Shari'ah compliant assets has also risen to an estimated \$400 to \$500 billion.<sup>128</sup> Other monitoring agencies like Standard & Poor's Ratings Services estimate the potential of Islamic financial services to be closer to \$4 trillion. The market share of these financial institutions is estimated at 17 per cent in the six Gulf Co-operation Council (GCC), and it is growing.<sup>129</sup> Recent figures indicate that Islamic banks operating in over 75 countries have total assets of about \$300 billion and their annual growth rate exceeds 15 per cent.<sup>130</sup> In 2010, The Financial Times estimates the value of the industry at the excess of \$1 trillion.<sup>131</sup>

Nienhaus, however pointed out that despite any administrative or bureaucratic role given to Shari'ah scholars, they often see themselves more as legal advisers and custodians of religious principles than officers in the business and financial regulation.<sup>132</sup> The perspective of Islamic economists is that which saw the developing of models of interest-free and profit and loss-sharing economies since the second half of the last century.<sup>133</sup> With this growing "idea of 'form over substance', which will be discussed later, Islamic finance has become a profitable segment of the global finance industry."<sup>134</sup> In its present form he argues, it is neither more ethical nor more efficient or stable than 'prudent' conventional finances because the replication of conventional

---

<sup>126</sup> Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10 (4), 155-199.

<sup>127</sup> Jobst, A. A. (2007). Derivatives in Islamic finance. *Islamic Economic Studies*, 15(1).

<sup>128</sup> Al-Amine, M. A. B. M. (2008). Sukuk market: Innovations and challenges. *Islamic Capital Markets*, 33.

<sup>129</sup> Godlewski, C. J., Turk-Ariss, R., and Weill, L. (2013). Sukuk vs. conventional bonds: A stock market perspective. *Journal of Comparative Economics*, 41(3), 745-761.

<sup>130</sup> Chong, B. S., and Liu, M. H. (2009). Islamic banking: interest-free or interest-based?. *Pacific-Basin Finance Journal*, 17(1), 125-144

<sup>131</sup> Financial Times Special Report: The Future of Islamic Finance, December 14, 2010.

<sup>132</sup> Nienhaus, V. (2011). Islamic finance ethics and Shari'ah law in the aftermath of the crisis: Concept and practice of Shari'ah compliant finance. *Ethical perspectives-Katholieke Universiteit Leuven*, 18(4), 591-623.

<sup>133</sup> Bremmer, I. (2010). The end of the free market: who wins the war between states and corporations?. *European View*, 9(2), 249-252.

<sup>134</sup> Nienhaus, V. (2011). Islamic finance ethics and Shari'ah law in the aftermath of the crisis: Concept and practice of Shari'ah compliant finance. *Ethical perspectives-Katholieke Universiteit Leuven*, 18(4), 591-623.

products including complex structured products similar to those that contributed to the recent financial crisis took place with the approval of prominent scholars on the Shari'ah boards of Islamic financial institutions.<sup>135</sup>

Scholars such as Chong and Liu argued that in practice Islamic banking is not very different from conventional banking and that Islamic deposits are not interest-free, but are closely pegged to conventional deposits.<sup>136</sup> This however cannot be generalised as the study was restricted to Malaysian finance institutions which shows that only a negligible portion of Islamic bank financing is strictly on profit and loss sharing basis. The general situation of contemporary global capital market including most financial institutions in the Islamic world is that most of the governing laws when it comes to contract that involve investment that relate to foreign institutions are conventional laws.<sup>137</sup> This is despite the fact that these contracts are supposed to be based on Shari'ah principles.

What is rather important however is that, even as some Islamic finances mimic conventional ones; there is still the deep ethical underpinning that is often guided by Islamic principles. This entails the avoidance of any contract or investment that involves interest (riba), Gambling (maysir) and uncertainty (gharar).<sup>138</sup> Islamic jurists claim those investments that are devoid of this phenomenon of uncertainty; interest and gambling are more stable, fair and efficient. Hence, finances and investment in Islamic countries are keen to adopt what is clearly devoid of these factors. Nienhaus went further to argue that the practice of Islamic banking has reduced the potential differences to actually subtle distinctions in the contractual basis of financial transactions.<sup>139</sup>

The greater challenge is that the existing mechanism of Shari'ah in product development; compliance and approval may be insufficient for a rapidly expanding and

---

<sup>135</sup> Ibid.

<sup>136</sup> Chong, B. S., and Liu, M. H. (2009). Islamic banking: interest-free or interest-based?. *Pacific-Basin Finance Journal*, 17(1), 125-144.

<sup>137</sup> Al-Amine, M. A. B. M. (2008). Sukuk market: Innovations and challenges. *Islamic Capital Markets*, 33.

<sup>138</sup> Cattelan, V. (2009). From the concept of haqq to the prohibitions of riba, gharar and maysir in Islamic finance. *International Journal of Monetary Economics and Finance*, 2(3-4), 384-397.

<sup>139</sup> Nienhaus, V. (2011). Islamic finance ethics and Shari'ah law in the aftermath of the crisis: Concept and practice of Shari'ah compliant finance. *Ethical perspectives-Katholieke Universiteit Leuven*, 18(4), 591-623.

interconnected global market.<sup>140</sup> The need to adhere to international standards and practices as well as the changing nature of customer demands for new and different forms of products is a real challenge. Hence, bodies such as the Organisation of Islamic Countries (OIC) or the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) have made attempts to deal with these challenges but there are still suffering from a number of shortcomings.<sup>141</sup> As would be seen in the subsequent chapters of this research for instance, the practical aspects of Ijarah or even Musharakah, have not been extensively discussed by the OIC Fiqh Academy, despite the presence of these finances in the market for many years and that Academy is the highest and most influential Shari'ah institution addressing financial issues.<sup>142</sup>

The implication of this is that, since these products have been in the market for some time, any future pronouncement by the Academy, especially if it comes out to denounce these contracts as non-compliant with Islamic principles is bound to raise grave controversies.<sup>143</sup> Likewise, any approval of the existing structures, despite their shortcomings, might generate another controversy as some jurists might take it as a compromise of Shari'ah principles.<sup>144</sup>

Some Islamic bankers argue that the principle of Islamic finance may even have a positive effect in underpinning the stability of the international economy.<sup>145</sup> This they argues is because Islamic financing system, investments or finance is targeted not only towards the profit and also the reliability and the needs of the parties.<sup>146</sup> Moreover, the investors and financiers must exercise due diligence in monitoring the investments and do not have the leverage of raising a variety of unsecured debts that may later affect the borrower.<sup>147</sup> This they argue is contrary to conventional Western financing which, through different methods and products lacks a corrective mechanism to stop excessive borrowing beyond individual companies' means. In good times argued Zaher, "raising

---

<sup>140</sup> Crawford, Fred. 2000. "Developing Financial Products in Islamic Finance," Paper Presented at the Fourth Islamic Finance Program at Harvard University on September 30/October 1, 2000, Boston, Massachusetts.

<sup>141</sup> Al-Amine, M. A. B. M. (2008). Sukuk market: Innovations and challenges. *Islamic Capital Markets*, 33.

<sup>142</sup> Ibid.

<sup>143</sup> Al-Amine, M. A. B. M. (2008). Sukuk market: Innovations and challenges. *Islamic Capital Markets*, 33.

<sup>144</sup> Ibid.

<sup>145</sup> Dudley Nigel. 1998. "Islamic banks aim for the mainstream." *Euromoney*, London. 349, 113-116.

<sup>146</sup> Ibid.

<sup>147</sup> Siddiqui, A. (2008). Financial contracts, risk and performance of Islamic banking. *Managerial Finance*, 34(10), 680-694.

funds is easy, while in bad times the cost of raising funds is high; therefore, the risk to the financing institution is increased.”<sup>148</sup>

Principally, the regulations guiding Islamic finances are those rooted in Islamic theology. Islamic jurists have continuously provided economic rationales to support this position. Some of these rationales as described by the International Association of Islamic Banks can be summarised as follows:<sup>149</sup> That Islamic principle on the allocation of funds to investment should be based on soundness of the project and profit sharing and return on capital will depend on productivity. It should also include the creation of additional wealth to the owner of the original capital. Hence, speculative businesses have to be avoided but one can engage in secondary markets for trading stocks based on fair profit-sharing principles. But it is also a principle that the supply of money does not overstep the supply of commodity. This is to curb inflation.<sup>150</sup>

However, it is important to note that Shari’ah contains no condemnation of what is seen as fair investments that yield profits.<sup>151</sup> What is clearly prohibited is the paying or receiving of interest. Hence, this challenge of compliance to Islamic tenets often prevents observant Muslims from taking out mortgages, carrying balances on credit cards or investing in any fixed income securities or any other financial security that promises a guaranteed return.<sup>152</sup> This goes to show that Islam does not frown at investment that yields profit. The underlying issues lies in the areas of the emphasis on tangible products and the equitable sharing of profit and risk. It is therefore obvious that Islamic financing functions much like Western equity financing where investors and lenders have the right to a decent rate of return, the distinction comes when issues relating to certainty of the return is brought in. As Zaher states, the “direct correlation between investment and profit differentiates Islamic banking from conventional or western banking, which defines maximization of the shareholders’ wealth as the sole

---

<sup>148</sup> Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10 (4), 155-199.

<sup>149</sup> Ibid.

<sup>150</sup> Ibid

<sup>151</sup> Siddiqui, A. (2008). Financial contracts, risk and performance of Islamic banking. *Managerial Finance*, 34(10), 680-694.

<sup>152</sup> Jobst, A. A. (2007). The economics of Islamic finance and securitization. *IMF Working Papers*, 1-35. See also, Tomkins, C., and Karim, R. A. A. (1987). The Shari’ah and its Implications for Islamic Financial Analysis: An Opportunity to Study Interactions among Society, Organisations and Accounting. *The American Journal of Islamic Social Sciences*, 4(1).. Also in, Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10(4), 155-199.

objective of the firm.”<sup>153</sup>

What is obvious about the growth of the Islamic finance is that it is still challenged by the debate on compliance with strict principles of Shari’ah. This debate is expected to go on as more products and services emerge. But the Islamic market is also poised to harness the opportunities that the global capital market presents. Hence, there is the need to continue revisiting these issues and devise ways that would sustain the Islamic capital market in the long run. A robust research and collaboration among Shari’ah jurists and Islamic economists to device ways that and standards that will enable cooperation with international financial market is important.

## 2.5 Discussing compatibility: Islamic vs. Western regulatory approach

The extent to which Islamic financial regulatory approach is compatible with western models in co-opting new products and services and also addressing the challenges of financial markets seemed to be a question of how well the harmonisation of different products and services are made and how they are traded in the market. But it is also evident that statutory provisions in economic laws of the state that cover both products and services are mainly constructed to accommodate most of the fundamental issues of Shari’ah finance such as issues of interest and of gambling. Hence, the Saudi CMA, for instance, spelt out that questions of compatibility in terms of products, services and regulations general has little or no relevance since there are legal provisions, which are meant to manage Shari’ah compliant products and services in a full-fledged Islamic context.<sup>154</sup> This study would show later that these are quite distinct from systems in western countries where the question of interest is an integral part of standard banking and finance and products that could amount to gambling in Islamic context are well within the accepted industry practice in the west. To be precise, gambling industries are big businesses allowed to flourish in most western countries.

There are other issues that define regulations in Islamic communities, which include the question of regulatory manner adopted as formal, substantive or dual. In a formal

---

<sup>153</sup> Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10 (4), 155-199.

<sup>154</sup> Ibid.

regulatory model, for example, the requirements for the Shari'ah Supervision Board to achieve standards for Shari'ah compliant outcome is determined by regulator's powers.<sup>155</sup> Thus, Shari'ah scholars affiliated with regulatory entities are tasked with responsibility of making rulings on the standards that financial market and services should comply with. In a 'substantive' model however, the regulators or its delegated Shari'ah scholars rather than the regulated entities are responsible for making such rulings.<sup>156</sup> In the 'dual' regulatory approach, the regulators are not only issuers of rulings or licences, they are also saddled with the responsibility of ensuring the enforcement of the Shari'ah-compliance of the products and services of regulated entities.<sup>157</sup> Again, these individuals or groups are mandated to give rulings based on Shari'ah principles as against the western system, which is purely secular, and regulations are guided by economic theories as well as the trajectories that guide the interests of the state and the financial industry.

Epistemologically, the law and enforcement mechanism of Shari'ah compliant products and services is distinct from their western counterparts.<sup>158</sup> These distinctions often depend on moral obligations that validate the right of ownership and manner of transferability of such ownership within an economic context and nature of products being traded. As practised throughout civilisation, the right of ownership of property is one of the cardinal principles enshrined under Islamic law. This principle is validated under the jurisprudential rubric that allow one person to lawfully transfer ownership of his belonging to another. One of the recognised ways through which such ownership can be transferred is through an honest financial transaction.<sup>159</sup> i.e., transactions done ethically and based on agreed terms and conditions such as offering certain goods or services and acceptance of the same upon agreed price and payment mode on specified date.

---

<sup>155</sup> Henderson, A. (2007). Limiting the regulation of Islamic finance: lessons from Dubai. *Law and Fin. Mkt. Rev.*, 1, 213-243.

<sup>156</sup> Ullah, S., and Jamali, D. (2010). Institutional investors and corporate social responsibility: the role of Islamic financial institutions. *International review of business research papers*, 6, (1) 619-630.

<sup>157</sup> Ibid.

<sup>158</sup> Oseni, U. A., and Hassan, M. K. (2014). Regulating the governing law clauses in Sukuk transactions. *Journal of Banking Regulation*.

<sup>159</sup> Ray, N. D. (1995). *Arab Islamic banking and the renewal of Islamic law*. Graham and Trotman.



The invalidation of financial transactions under Islamic law mostly occurs due to certain unlawful practices that are contrary to Islamic norms and values.<sup>160</sup> While there are clear positions on western trading methods, common products and party consent, there are certain exceptionally grey areas that have evolved as a result of changes in the nature of markets. Some of these challenges for example are those regarding products of financial markets, which, in Islamic finance are seen as complex in terms of trading and legitimacy. They include such things as debentures, bonds, preferred stocks, commercial paper, etc. The unsettled question on trading in these financial instruments in Islamic financial law is due to the fact that they are debt-based securities and therefore have the potential of some form of interest and conditionality attached to them.<sup>161</sup> Although Preferred stock is often capital rather than debt finance, it still has the tendency of having features of debt such as a fixed coupon and a preference as to payment over ordinary shares. In some cases, it may be redeemable which may give the appearance of a more debt-like structure. The lack of consensual legal opinion on permissibility or otherwise of trading in these financial markets' instruments, which is due to methodological question raised for ruling on such trading matter that depends on personal opinion of Shari'ah scholars.<sup>162</sup>

However, the lack of consensual legal opinion on tradability of some of these financial instruments is both methodological and theoretical of concern to contemporary Shari'ah scholars. It has created an array of complexity and contemplation on how to screen such instruments to comply with Islamic financial standards. The most common methodological provisions to consider while determining the permissibility of trading in these instruments depends on, which of the four classical legal paradigms Shari'ah scholars derived their ruling from. This is because there is no clear textual ruling in primary and secondary Islamic legal sources, Qur'an and Sunnah. This is due to novelty of the nature of trading practice in the financial instruments in question. To those jurists who approve business transactions in financial instruments to the extent of one of the accounts generating low-interest income and their financing bearing below-average debt-to-equity ratio, the permissibility of such trading is granted on condition that the

---

<sup>160</sup> Iqbal, Z., and Mirakhor, A. (2011). *An introduction to Islamic finance: theory and practice*. John Wiley and Sons.

<sup>161</sup> Khan, Z., Jawaaid, S. T., Arif, I., and Khan, M. N. (2012). Working capital management and firm's profitability in Pakistan: A disaggregated analysis. *African Journal of Business Management*, 6(9), 3253-3261.

<sup>162</sup> Ibid.

profits generated from such interest-bearing account shall be purified if the amount of the profits realised from interest-bearing account is granted to charity directly or through charitable organisations. This is because Islamic financial law prohibited the debt-financing transaction given the reason of interest it bears.

With the introduction of the contemporary financial market instruments, the Shari'ah scholars' understanding of the concept of interest (*riba*), has shifted qualitatively and quantitatively on the extent to which a transaction in debt-based financing practice is prohibited in Islam. As Farooq argues that the prohibition in the Qur'an and the commonly cited hadiths to that defined *riba* can be easily understood in the case of *riba al-jahiliyyah*, and the rationale for it is unambiguous.<sup>163</sup> But, all the definitions of *riba* and especially to broaden the scope to reach interest in the modern economy in all its forms (including interest in a competitive, regulated environment) is a daunting task.<sup>164</sup>

This, according to Farooq, is because Islamic economics developed as part of the revivalist movements seeking to bring about the Islamic model that would be in lieu of other systems of economy, including capitalism and socialism.<sup>165</sup> The challenge then became that of dealing with Islamic rulings that will guide the emerging and changing complexity in capital and commodity markets. Osman for instance discussed this complexity and the 'risk factor' associated with it.<sup>166</sup> He argues that the contemporary global village has developed in terms of mass marketing that an Australian company may have an enterprise in Malaysia or Pakistan and may rely on financing from European banks.<sup>167</sup> This according to Osman, has increased the need for specialised establishments to deal with a globalised and interconnected financial system.<sup>168</sup> Added to this ethos is the fact that such financial institutions are often not owned by

---

<sup>163</sup> Farooq, M. O. (2006). *Riba, interest and six hadiths: do we have a definition or a conundrum?*. Unpublished essay. See, <http://www.assaif.org/chi/content/download/33174/174384/file/Riba-hadith.pdf> p26.

<sup>164</sup> Ibid.

<sup>165</sup> Dr. Mohammad Omar Farooq *The Riba-Interest Equivalence: Is there an Ijma (consensus)* (2006). See, <http://www.globalwebpost.com/farooqm/writings/islamic/r-i-consensus.html/>

<sup>166</sup> Osman, F. (1999). *Concepts of the Qur'an: A Topical Reading*. Los Angeles: MVI Publications.

<sup>167</sup> Ibid.

<sup>168</sup> Ibid.

individuals, instead they rely on the patronage and investment of wide range of depositors, borrowers, and shareholders.<sup>169</sup>

One of the conundrums therefore became the issue of discerning of interest-based facilities from non-interest ones. Although there is a strong and overwhelming position among most scholars on the prohibition of *riba* (usury), there are also some minority opinions on the subject matter, especially outside the main areas that involve interest relating to deferment of payments (*riba al-nasia*) and those relating to exchange of commodities (*riba al-fadl*). Despite the differences in opinion and interpretation, the general consensus among Islamic jurists is that interest is prohibited, especially the ones clearly defined are prohibited.<sup>170</sup> Gradually however, Islamic jurists extended the scope, based on new developments into include all forms of interest i.e. high or low rate, nominal or real, etc. The debate has not stopped yet.<sup>171</sup>

Taking these theoretical models of Islamic financial screening differently into consideration, the underlining issues they raised inform how the understanding of concept of interest is one of the central concerns in Islamic financial system. And the extent to which the variation in opinion on criteria to rule on its permissibility or otherwise among the classical and contemporary Islamic scholars, which have shifted the debate on legal issues in regulating trading in debt financing of some markets' instruments. The qualitative method of screening permissibility or otherwise of trading opportunities in financial markets is based on passing judgment on issues that there is clear textual rulings on them derived from the first and second sources of Islamic Law, Qur'an and Sunnah. For example, investing in a market whose business activities constitute trading in alcoholic beverages or pork are religiously prohibited and therefore considered impermissible. The quantitative method, however, is a screening approach, which is aimed to define Islamic financial index by assessing the company's financial ratio. For example, some Shari'ah Advisory Boards measure debt-to-equity of the company's financial ratio over market capitalisation (i.e. business's worth), criteria that used by Dow Jones Islamic Market World, DJIM. Other Shari'ah Advisory Boards like

---

<sup>169</sup> Dr. Mohammad Omar Farooq The Riba-Interest Equivalence: Is there an Ijma (consensus) (2006). Accessed on 07/02/2014. <http://www.globalwebpost.com/farooqm/writings/islamic/r-i-consensus.html/>

<sup>170</sup> Tariq Talib al-Anjari. "Islamic Economics and Banking." See, [http://islamic-world.net/economics/economic\\_banking\\_01.htm](http://islamic-world.net/economics/economic_banking_01.htm);

<sup>171</sup> Dr. Mohammad Omar Farooq The Riba-Interest Equivalence: Is there an Ijma (consensus) (2006). See, <http://www.globalwebpost.com/farooqm/writings/islamic/r-i-consensus.html/>

Financial Time and London Stock Exchange (FTSE) and Morgan Stanley Capital International's (MSCI) financial ratio measurement is debt-to-equity over the assets. The significance of these screening techniques is to measure the interest and debt rates to determine the rate of income generated by the interest and liabilities incurred by the debt.<sup>172</sup>

In reference to the vehement opposition to the concept of interest-based financial services, some contemporary Islamic scholars have illustrated how interest-free capital is less volatile and more secure, while the paying of higher interest rates diminishes liquidity and is likely to destabilise the market. The question of interests and those of the legitimacy of products and services has been at the centre of every debate on Islamic finances. It is also relevant to regulatory frameworks of Islamic financial markets, their stability and indeed the ability to prevent market abuses.

How financial transactions should be conducted via an institutionalised and interest-free model in the contemporary financial markets that are dominated by secular practices as well as sophisticated and innovative financial products and services, is a challenge for Islamic finances. Hence, the need to thoroughly study and scrutinised the system and products to determine their compatibility with Shari'ah values. To resolve this and other issues brought about by western financial market models, contemporary Shari'ah scholars have constantly admitted how daunting and painstaking their task is, especially that which entails interpreting the 14<sup>th</sup> Century legal texts in offering rulings as to the legality of some of contemporary financial transactions. Thus, the extent to which the conception of interest in traditional practice differs from the contemporary interest-based financial transactions need to be discerned.

## 2.6 Conclusion

As markets around the world continue to come up with innovative products and services, they also become more integrated and interrelated, the Saudi capital market is also poised to expand beyond its present status. This is evident in the growth that the industry has seen over the last two decades. Yet, the continuous globalisation of the

---

<sup>172</sup> El-Hawary, Dahlia, Wafik, G. and Zamir, I. (2004). "Regulating Islamic financial institutions: The nature of the regulated." *World Bank Policy Research Working Paper* 3227.

capital market and the need to attract more foreign investment and capital means the Saudi market has to continue to explore the possibilities of more products and services based on the opportunities and potentials that Shari'ah presents as a way of harmonising the system especially with the constraints on usury, gambling and speculative trading and contracts.

Globalisation of the financial market has brought about interconnectivity, enhanced competition and presented new challenges. The growth of the industry is however in different pace, those in the west have more products and services and have enormous capital and participants than their growing counterparts in countries like Saudi. The main challenge for Islamic countries such as Saudi is largely on the obligation to implement financial structural reform based on the principles of Shari'ah. Hence, the quest for diversification and innovation is also constrained by the need to abide by religious tenets. But studies have also shown the constant willingness of economists in the Islamic world to innovate products and services while drawing extents and limits from the prevailing provisions of the Shari'ah. The motivation to do this could be attributed to the variety of products and services and the volume of trade and investment emanating from western models.

What is also evident is that, over the last two decades, there appears to be a growing interest in Islamic finance and capital markets, which allow the industry to grow especially in the gulf nations with Saudi leading the way. This has also given Islamic scholars the challenge of identifying different products and services and weighing their character and characteristic on the scale of permissibility under Shari'ah. But it must also be stressed that a number of these scholars see themselves more as advisors than guardians of practical business ethics.

As new products and services emerge in Islamic countries, there is the ever-present ethical and religious underpinning that necessitates the avoidance of products and services involving interest, gambling and uncertainty. The greater challenge is that developing Shari'ah compliant products of all kinds may prove difficult in a rapidly expanding financial market proliferated with all kinds of products. Another challenge is the need to attract foreign investment in the midst of limited kinds of products. Moreover, the regulations for Shari'ah compliant products sometimes differ from

western provisions. These distinctions according to scholars are a reflection of certain moral obligations on ownership and transfer products and assets. But there are still many areas where the two converge, especially in terms of consent, in disallowing manipulation. It is also true that certain grey areas have emerged because of the emergence of new and complex products and services, which are often not readily clear to the individual. As much as some of these products remain complicated so is the question of their legitimacy under Shari'ah. Hence, there are instances where Islamic financial experts could not agree on the permissibility or otherwise of some of these products and services. As a result, the major point of discussion on these products had been the test to determine legality through the classical sources of Shari'ah.

Other issues that have to be explored in order to create markets for products including the requirement of Shari'ah that real sector activities and real assets must back finances. Hence, there is the need to require the constant role of jurists and economists to find ways of consolidating and developing these ideas. Often through Ijtihad, many options have become possible that ensured products are restructured and made in a way that is permissible under the Shari'ah. However, as scholars such as Jabeen and Khan maintained, for the Islamic capital market to fulfil the principles of Shari'ah, it is evident that not only should the products be backed by real assets, their returns should also not be linked and benchmarked to the conventional money market instruments or LIBOR.<sup>173</sup> This clearly differentiates Shari'ah compliant finances with Western finances that have complex contracts such as the CDS. In this respect, Islamic banks have proven to be more stable and safer. This to a larger degree is a point of divergence between capital markets in the regimes like the UK and in Saudi.

Although at a very nascent stage, the field of research is continuously moving towards exploring opportunities, that within Shari'ah principles, the market can be opened not only to equity but also to other products, with the exception of conventional debt based products that are clearly opposed under the Shari'ah. What also appears foremost to policy makers in Saudi is the resolve consolidate on increasing growth of the capital market and continue reforms that would bring in more investment into products and services that are both attractive and Shari'ah compliant.

---

<sup>173</sup> Jabeen, Z., and Khan, M. R. (2008). An Inquiry into The Usage of Real Assets in Islamic Transactions and Their Benchmarking: The Implications for Islamic Capital Markets. *Islamic Capital Markets*, 69.



## Chapter Three

### Transformation of the Islamic Capital Market Economy: A conceptual perspective

#### 3.1 Introduction.

Creating a financial market system that has the incentives and the variety of products to attract investors both at home and from foreign lands has been one of the economic objectives of Saudi Arabia. The main challenge however is that the principles of finances are mainly regulated by the rules of the Shari'ah. Yet, policy makers are constantly looking at ways to expand the market in a way that does not necessarily breach Shari'ah principles. They are also aware of the need to diversify the market away from the huge reliance on energy export to providing new ways of investment in capital market through the provision of different investment products and services.

Islamic finance has a number of concepts that were designed in a way that replicates some of modern finances. And as the industries in the Islamic world were poised to reach out to international investors and markets, challenges arose as to how the system would adapt into the larger framework with different kinds of concepts that define the various products in other financial markets, while taking into context the custom (*Urf*) of Islamic finances and how the various aspects that define Sukuk can be harmonised. This saw the transformation of the concept of Sukuk to include bonds of different kinds. This chapter intends to look at these concepts and how they transformed to reflect and fulfil the quest of the financial experts of the Islamic world like Saudi.

#### 3.2 The concept of Islamic customs in finance (*Urf*)

The concept of legal origin as earlier stated helps explain many of the political and economic structure of societies. In a society that is historically and predominantly of Islamic origin, jurisprudence is mainly a question of Islamic customs and regulations or deeply influenced by Shari'ah doctrines. Known commonly as the principle of *Urf*, custom,<sup>174</sup> the Islamic custom suggests the peculiarity of human societies despite their common religious affinities, is one of the bases of Islamic juridical preferences. It also suggest that legal issues are not only acceptable because they are they are common to

---

<sup>174</sup> Al-Haddad, H., & el-Diwan, T. (2010). Boom, bust, crunch: is there an Islamic solution?. See [http://www.islamic-finance.com/item153\\_f.htm](http://www.islamic-finance.com/item153_f.htm)



any given societies, but also because they are endorsed by the divine injunctions.<sup>175</sup> As one of legal methodological approaches to be considered in understanding of development and enforcement of laws in Islamic legal framework that covered all aspects of Muslims' endeavours, it is, therefore, imperative to discern how Islam enforces law in regulating financial markets in ensuring their stability by deterring any abuses. Unlike the western financial transactions, business in Islamic perspective must conform to divine principles embedded in values whose objectives are fairness, equality and moral responsibility.<sup>176</sup> Another significant principle to discern in the evolutionary nature of the Islamic legal system is the principle of public interest<sup>177</sup> as one of considerable factors that underline the law enforcement mechanism in Islamic legal system as well as the right of private ownership.<sup>178</sup>

It is on these and similar other principles that Islamic laws are endorsed to permit or prohibit an act such as interest, speculation, etc., in Islamic financial transactions. The prohibition of interest and speculation in Islamic financial transactions is informed by prohibition on the exploitation of labour and poor risk management as such financial practices inflict damage to economic development and the growth of a society.<sup>179</sup> To ensure fairness in financial activity, the Islamic financial system is structured on the basis that ensures profit and risks are shared reasonably. This principles of profit-loss-sharing is central to Islamic finance, which also insist that regulators must monitor both products, services and the attitude of market participants to ensure fairness and stability in the market.<sup>180</sup>

Having briefly considered the methodological approach of Islamic financial principles, the major task of this section is to examine the operation of financial markets in Islamic societies with particular reference to the Saudi Capital Market Authority and its law

---

<sup>175</sup> Auda, J (2008) *Maqasid Al-Shari'ah as Philosophy of Islamic Law: A System Approach*. London: *The International Institute of Islamic Thought*, pp124

<sup>176</sup> Finance (2012) 'Business Ethics in Islamic Finance'. See, <http://www.qfinance.com/business-ethics-checklists/business-ethics-in-islamic-finance>.

<sup>177</sup> Auda, J (2008) *Maqasid Al-Shari'ah as Philosophy of Islamic Law: A System Approach*. London: *The International Institute of Islamic Thought*, pp124

<sup>178</sup> Al-Haddad, H., & el-Diwany, T. (2010). Boom, bust, crunch: is there an Islamic solution?. See, [http://www.islamic-finance.com/item153\\_f.htm](http://www.islamic-finance.com/item153_f.htm)

<sup>179</sup> Iqbal, Z., and Mirakhor, A. (2011). *An introduction to Islamic finance: theory and practice*. John Wiley and Sons, p 9.

<sup>180</sup> Iqbal, M. (2001) *Islamic Banking and Finance: Current Developments in Theory and Practice*. Leicester: *The Islamic Foundation*. pp. 19 – 20.

enforcement jurisdictions. This will also further trigger the discussion on Islamic financial products and services and the effectiveness of Islamic financial market regulatory model in coping with markets abuses. With such a mindset, the discussion will bring forth the different views of Islamic financial legal scholarship. In that, Islamic financial system scholars' debate on regulation of Islamic financial markets is framed on formal and substantive issues pertaining to the law enforcement jurisdiction. The formal approach to regulating market entails that products and services providers are saddled with responsibility to regulate their financial activities rather than the regulators.<sup>181</sup> However, the substantive approach suggests that regulators instead of products and services providers are to "seek to determine Shari'ah-compliance within the matrix of investor protection and market integrity."<sup>182</sup>

The law enforcement model under the Saudi Capital Market Authority (CMA) is categorised as a 'formal' system within the context of the Global Islamic Finance Report (GIFR),<sup>183</sup> and 'private' in western scholars' perspective. This is because, the CMA does not 'scrutinise the Shari'ah credentials of a products or service.'<sup>184</sup> Despite the Shari'ah Legal System being the basic source of its laws; there are no legal instruments such as legislative ruling or guiding principles such as the AAOIFI and Islamic Financial Services Board (IFSB) let alone a national Shari'ah Board in place.<sup>185</sup> The operation of Shari'ah compliant Islamic finance is evident from the four existing Islamic schools of jurisprudence. Some western banks are externally regulated by secular<sup>186</sup> ruling legislation which allows each bank to adopt its own Shari'ah board internally.<sup>187</sup>

Other issues to be considered as to Saudi financial system regulatory model include, understanding of the existing aspects of Saudi that in many ways resemble those of

---

<sup>181</sup> Dar, H and Azami, M. T. A. eds. (2011) 'Regulatory Issues: Challenges and Solutions'. *Global Islamic Finance Report*. London: BMB Islamic UK Limited, p. 144.

<sup>182</sup> *ibid*, p. 144.

<sup>183</sup> The Global Islamic Finance Report is an annual comprehensive review of the activity and developments in the Islamic finance industry. It commissions contributions from leading global practitioners and thinkers in Islamic and global financial markets.

<sup>184</sup> *Ibid*, p. 332

<sup>185</sup> *Ibid*.

<sup>186</sup> Metz, H. C. ed. (1992) *Saudi Arabia: A Country Study*. Washington: GPO the Library of Congress. See, <http://countrystudies.us/saudi-arabia/51.htm>

<sup>187</sup> Dar, H and Azami, M. T. A. eds. (2011) 'Regulatory Issues: Challenges and Solutions'. *Global Islamic Finance Report*. London: BMB Islamic UK Limited, p. 144.p. 332

western financial markets such as insurance, real estate market, etc. This resemblance is due to legal lacuna existing in the rapid legislative response to enact relevant regulatory laws in such sectors especially in insurance, real estate mortgage, and other services.<sup>188</sup> This has also raised the debate on Shifting the focus of the debate on whether bank-based or market-based financial system regulation is the better framework to distinguish financial systems and to assess their performance and stability.<sup>189</sup> Evidently, this debate was motivated by the realities of the Saudi stock market collapse of 2006 and how the government responded badly to it with the weak response of Saudi authorities to the Saudi Stock Market collapse of 2006, the need for more proactive laws and regulations was necessary to avoid a recurrence and to assure investors of safety.<sup>190</sup>

Critically assessing the causes of the collapse of the Saudi Stock Market and the response of the Ministry of Finance (Fiscal Authority) as well as Saudi Arabian Monetary Agency (SAMA), the event calls for analysing when public and private or a dual regulatory model is useful. The criteria to be used in support of each model could be defined by such theories of public interest and enforcement.<sup>191</sup> Besides, the role of the government to ensure an enabling legal environment for effective regulation of financial markets and services needs to be highlighted as well.

### 3.3. Islamic financial products: Sukuk and other instruments

There are a number of financial instruments or contracts that existed in Islamic history that are permitted under the Shari'ah. Over time, some of these finances had been reconfigured to reflect or mimic such investments as bonds. The expansion of the Islamic finance over the last twenty years has seen the growth of the Saudi capital market. It has also contributed to the growth of other products and services across Muslim majority countries, especially in the gulf region. A number of product and

---

<sup>188</sup> Saudi Gazette (2012) 'Saudi Arabia Issued 5 New Finance Laws'. See, <http://saudigazette.com.sa/index.cfm?method=home.PrintContent&fa=regcon&action=Print&contentid=20120705129018&simplelayout=1>

<sup>189</sup> Beck, T., Demirguc-Kunt, A. and Levine, R (2002) 'Law and Finance: Why Does Legal Origin Matter? *NEBER Working Paper No. 9379, JEL No. G2, K2, K4, O16, P5*. See, <http://www.nber.org/papers/w9379.pdf>. pp. 4 - 6

<sup>190</sup> Al Nwaisir, S. (2012) 'Saudi Stock Market Needs To Be Reformed'. See, <http://www.eurasiareview.com/11012012-saudi-stock-market-needs-to-be-reformed-oped/>

<sup>191</sup> Shleifer, A. (2005) 'Understanding Regulation'. *European Financial Management*, Vol. 11, No. 4, pp.440–445. See, [http://scholar.harvard.edu/sites/scholar.iq.harvard.edu/files/shleifer/files/02\\_eufm00121.pdf](http://scholar.harvard.edu/sites/scholar.iq.harvard.edu/files/shleifer/files/02_eufm00121.pdf)

services were also introduced including Sukuk which is a Shari'ah compliant type of bonds. This was part of what was seen as an attempt by Saudi to harness the advantages of the growing global capital market. As of January 2015 the Tadawul lists 169 publicly traded companies. Some of these changes, as Zaher and Hassan argue, were influenced by factors that include the introduction of broad macroeconomic and structural reforms in financial systems, the liberalisation of capital movements, privatisation, the global integration of the markets, and the introduction of new innovative products.<sup>192</sup> They however, maintained that a complete Islamic financial system with its identifiable instruments and markets is still very much at an early stage of evolution and still coping with numerous challenges relating to regulations and instruments.<sup>193</sup> The major issue for Islamic jurists, especially regarding the transplant of western style financial instruments is the nature of interest, as well as the amount of risk that is mostly a result of uncertainty and sometimes lack of transparency. The problem of interests is one that leads to counterparty risk of the borrower being unable to pay, which results in increase in price until payment of interest is due and falls back again after payment of interest. What Islamic scholars identified are those contracts regarded traditionally as less risky, more transparent and simple, and ways in which their transformation will not contradict the principles of Shari'ah:

**(a). Mudarabah and Musharakah**

Mudarabah is a contractual relationship executed between two parties, one supplying the capital (called rabb-ul-mal), and the other supplying the labour or skill in his capacity as an agent or a manager of the investment (called Mudarib). Each party shall be entitled to a share of the profit and the ratio upon which the profit is to be shared is explicitly stated and agreed at the beginning of the contract. Essentially, Mudarabah is a trust based financing agreement akin to some a Western- style limited liability partnership. Meaning that partners who contribute a set of capital to the partnership are only liable to the limit of their capital only.<sup>194</sup> Mainly, this contract consists of one

---

<sup>192</sup> Jalil, M. A., and Rahman, M. K. (2010). Financial transactions in Islamic Banking are viable alternatives to the conventional banking transactions. *International Journal of Business and Social Science*, 1(3), 220-234.

<sup>193</sup> Ibid; See also, Zaher 155 Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10 (4), 155-199.

<sup>194</sup> Limited Liability Partnership Act 2000. Available at See, <http://www.legislation.gov.uk/ukpga/2000/12/contents>.

party contributing capital while the other runs the business, and profit is distributed based on a negotiated percentage of ownership.<sup>195</sup> In case of a loss, the lender earns no return on the investment and the agent receives no compensation for his or her effort.<sup>196</sup>

Closely related to Mudarabah is Musharaka, which is a joint venture, whereby two parties i.e. the lender and the client contribute the capital for a business or project.<sup>197</sup> The capital is managed by both parties and profits shared based on pre-agreed ratios. In the event of loss, it is shared in proportion to equity participation of each of the parties. Some Islamic jurists pointed out that Musharaka is the purest type of Islamic finance. It is according to Zaher, closer to a traditional equity stake with rights of control.<sup>198</sup> This resembles what in the UK is referred to as Joint ventures covered under the Partnership Act 1890 that refers to a relationship where two or more parties agree to work or collaborate together in a business venture.

Although there are similarities between Mudarabah and Musharaka, there are some obvious differences, which include where the capital comes from i.e. in Musharaka capital comes from all the partners, while in Mudarabah, it comes from one of the parties.<sup>199</sup> Moreover, unlike in Mudarabah, in Musharakah, all the parties engage in the management of the project.<sup>200</sup> Likewise, the ideas of profit and loss sharing differ. Difference between Musharakah and Mudarabah have been summarised by scholars in the following points:<sup>201</sup>

- (i). The investment in Musharakah comes from all the partners, while in Mudarabah, investment is the sole responsibility of *rabb-ul-mal*.<sup>202</sup>

---

<sup>195</sup> Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10 (4), 155-199.

<sup>196</sup> *ibid.*

<sup>197</sup> Ismayil, S. I. (2012). *The Principles of Islamic Finance, Its Challenges and Policy Suggestions for Azerbaijan*. Doctoral dissertation, Eastern Mediterranean University (EMU).

<sup>198</sup> Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10 (4), 155-199.

<sup>199</sup> Ismayil, S. I. (2012). *The Principles of Islamic Finance, Its Challenges and Policy Suggestions for Azerbaijan* (Doctoral dissertation, Eastern Mediterranean University (EMU).

<sup>200</sup> Meera, M., Kameel, A., and Abdul Razak, D. (2005). Islamic Home Financing through Musharakah Mutanaqisah and al-Bay' Bithaman Ajil Contracts: A Comparative Analysis. *Review of Islamic Economics*, 9 (2), 5-30.

<sup>201</sup> Wilson, R. (2006). Islam and business. *Thunderbird International Business Review*, 48(1), 109-123; Uusmani, M. T., and Taqī 'Uṣmānī, M. (2002). An introduction to Islamic finance. *Brill*.<sup>20</sup>

<sup>202</sup> This refers to the person who is the sole supplier of the funds for the business.

- (ii). In Musharakah, all the partners can participate in the management of the business and can work for it, while in Mudarabah, the *rabb-ul-mal* has no right to participate in the management which is carried out by the *mudarib* only.
- (iii). In Musharakah all the partners share the loss to the extent of the ratio of their investment while in Mudarabah the loss, if any, is suffered by the *rabb-ul-mal* only, because the *Mudarib*<sup>203</sup> does not invest anything. His loss is restricted to the fact that his labour has gone in vain and his work has not brought any fruit to him. However, this principle is subject to a condition that the *Mudarib* has worked with due diligence which is normally required for the business of that type. If he has worked with negligence or has committed dishonesty, he shall be liable for the loss caused by his negligence or misconduct. (4) The liability of the partners in Musharakah is normally unlimited. Therefore, if the liabilities of the business exceed its assets and the business goes in liquidation, all the exceeding liabilities shall be borne pro rata by all the partners. However, if all the partners have agreed that no partner shall incur any debt during the course of business, then the exceeding liabilities shall be borne by that partner alone who has incurred a debt on the business in violation of the aforesaid condition. Contrary to this is the case of *Mudarabah*. Here the liability of *Rabb-ul-mal* is limited to his investment, unless he has permitted the *Mudarib* to incur debts on his behalf.
- (iv). In *Musharakah*, as soon as the partners mix up their capital in a joint pool, all the assets of the *Musharakah* become jointly owned by all of them according to the proportion of their respective investment. Therefore, each one of them can benefit from the appreciation in the value of the assets, even if profit has not accrued through sales. The case of *Mudarabah* is different. Here all the goods purchased by the *mudarib* are solely owned by the *rabb-ul-mal*, and the *mudarib* can earn his share in the profit only in case he sells the goods profitably. Therefore, he is not entitled to claim a share in the assets themselves, even if their value has increased. It is important to note that this relationship in *Mudarabah* resembles an agency relationship.

---

<sup>203</sup> This refers to the person that manages the fund but does not contribute his money into the business.

**(b). Murabaha**

*Murabaha* is a kind of transaction, where the lender (intermediary) purchases a property, which is mostly a tangible asset. Here, the lender pays for the asset which is purchased by the lender at the request of a customer. As Zaher and Kabir described this model of contract, the lender then sells the property to the customer on a deferred sale basis with a mark-up reflecting the institution's profit. The customer takes the responsibility of negotiating all of the key commercial terms with the seller of the asset. The intermediary buys the property with free and clear title to it. The intermediary and prospective buyer then agree upon a sale price that can be made through a series of instalments, or as a lump sum payment.

It was also argued that a number of legal issues may be encountered in *Murabaha* transaction.<sup>204</sup> First is that Islamic financial institutions are not at liberty to earn excessive profit because if that happens, remedies may include a return of the "excessive" portion of the profit to the client. Another legal issue is that customers may reject the goods for non-conformity with the quality or description. But this is often dealt with in a way that the customer acts as the lender's agent in determining the goods prior to acceptance.<sup>205</sup> Zaher identified another challenge where the lending institution "may be exposed to contractual and statutory liabilities such as warranties resulting from its ownership of the goods. These should be disclaimed to the extent possible or be limited by indemnities received from the customer."<sup>206</sup> The risk is, however, not only to lending companies, purchasers, especially of immovable property.

**(c). Ijarah**

The term *Ijarah* was derived from the word *Ajara* which literally means to recompense, compensate or give a consideration and return.<sup>207</sup> *Ajr* is a word that refers to a wage

---

<sup>204</sup> Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10(4), 155-199.

<sup>205</sup> Al-Meathier, M. A., and Mitchell, C. J. Extending EMV to support Murabaha transactions. In *Proceedings of the 7th Nordic Workshop on Secure IT Systems (NordSec 2007)* (pp. 95-108). See also, Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10 (4), 155-199. And also Kettell, B. Murabaha as a Mode of Islamic Finance. *Introduction to Islamic Banking and Finance*, 43-61.

<sup>206</sup> Ibid.

<sup>207</sup> Kamali, M. H. (2007). A Shari'ah analysis of issues in Islamic leasing. *Islamic Economics*, 20 (1).

given to a worker and *Ujrah* to rental payment.<sup>208</sup> In its juristic usage, *Ijarah* primarily refers to both a rental as well as a hire contract that engages the services of persons. The permissibility of *Ijarah* is contained in the Qur'an and Sunnah.<sup>209</sup> Whereas the Qur'an and Sunnah only refer to *Ijarah* as an employment contract, the companions of the Prophet practised *Ijarah*, in the sense of employment as well as rental of real property.<sup>210</sup>

In modern context, *Ijara* is similar to a conventional operating lease, wherein an Islamic bank (lessor) leases the asset to a client (lessee) for an agreed lease payments for a specified period of time. This type of contract had been discussed by many scholars but always with some degree of unresolved issues in relation to permissibility under the Shari'ah.<sup>211</sup> *Ijarah* features both debt and equity because in one way it is similar to an asset-backed loan, and on the other it features equity because the nature of estimation process of expected salvage value can be positive or negative.<sup>212</sup>

Generally, *Ijarah* comes with no option of ownership for the lessee and the maintenance of the leased asset is the lessor's responsibility. According to Al-Amine this type of contract has four main characteristics:<sup>213</sup>

- (i). First is that *Ijarah* is tradable and negotiable in the secondary market.
- (ii). *Ijarah* bonds can be traded at prices determined by market forces. i.e. economic conditions of the financial market and opportunity cost and the price of real investment. The contract must also put into consideration issues relating to rental payment, changes in asset pricing and maintenance. The challenge here is that, maintenance cost and expenses are not predictable into the future.

---

<sup>208</sup> Ibid.

<sup>209</sup> Yusuf Ali, Qur'an English translation, 8: 77; 28: 26 and 65: 65-66.

<sup>210</sup> See for example, El-Gamal, M. A. (2007). Mutualization of Islamic banks. *Handbook of Islamic Banking*, 310.

<sup>211</sup> Warde, I. (2000) *Islamic Finance In The Global Economy*. Edinburgh University Press, Edinburgh. See also El-Gamal, M. A (2002). *Islamic finance: Law, economic and practice*, Cambridge University Press, Cambridge. And also Ebrahim, M.S. and Joo, T.K. (2001), "Islamic banking in Brunei Darussalam", *International Journal of Social Economics*, (28), 4, 314-337.

<sup>212</sup> Ebrahim, M.S. (2000), "Pricing asset backed Islamic financial instruments", *International Journal of Theoretical and Applied Finance*, (3) 1. 51-83.

<sup>213</sup> Al-Amine, M.B.M. (2001), "The Islamic bond market: Possibilities and challenges", *International Journal of Islamic Financial Services*, (3), 1.



Therefore, the expected return on some forms of Ijarah cannot be completely fixed at the inception of the contract.

- (iii). Ijarah offers flexibility, which means that rules in securitization of the Ijarah contract is the key factor to solving any liquidity management problem. Hence, it provides the condition to be a successful security.

Another form of Ijarah according to Al-amine is that which comes without any form of financial intermediaries to issue the instrument. Here, the ownership of the asset is transferred to sukuk holders<sup>214</sup> while the issuer or borrower becomes the beneficiary of the Ijarah or the user of the asset.<sup>215</sup> The general rule is that no premium is paid to the intermediary, but the issuer might take some contractual compensation from the transaction.<sup>216</sup>

One of the most mentioned objections against Sukuk-Ijarah is in relation to the issues of guarantee. Generally, in issuance, a third party who is the originator of the Sukuk-Ijarah will provide a guarantee for the principal capital of the Sukuk. This contention about guarantee arises when the originator (sovereign or corporate) benefits from the Sukuk proceeds, and goes further to establish a Special Purpose Vehicle (SPV) to issue the Sukuk while the originator steps aside only to provide a guarantee against any shortfall.<sup>217</sup>

The first collective resolution regarding Guarantee in Sukuk was issued by the Islamic Fiqh Academy in its resolution 30(5/4) pertaining to Muqaradah Sukuk. The resolution states the following:

"There is no Shari'ah objection to mention in the prospectus of the issue or in the document of Muqaradah Sukuk the promise of a third party, who is independent personally and in term of financial liability from the two parties to the contract, to volunteer an amount of money for no consideration to be allocated to make good a loss on a particular project. However, this is circumscribed with a condition that such a promise should be an obligation

---

<sup>214</sup> An owner of units of equal value of bond.

<sup>215</sup> Al-Amine, M.B.M. (2001), "The Islamic bond market: Possibilities and challenges", *International Journal of Islamic Financial Services*, (3), 1.

<sup>216</sup> *ibid.*

<sup>217</sup> *ibid.*

independent from the Mudarabah contract. In other words, the third party performance of his obligation should not be a condition for the enforcement of the contract and the conditions and liabilities of the parties to the contract. As such, neither the bond holder nor the manager of the Muqaradah would be entitled to claim that they may fail to honour their obligations relating to their contracts because the volunteer failed to fulfil his promise and the performance of their obligations takes into consideration the promise from the volunteer."<sup>218</sup>

While some scholars argue that if the third party guarantee is benevolent and given by a public entity such as the government for the sake of encouraging investment in the country, it is permissible, others hold an opposing view. For example, they contend that guaranteeing Ijarah may open the contract to vulnerability of usury. Also, where the third party is assumed to be benevolent, i.e. a government entity, it would still be impermissible because the concept of fairness to the populations is affected. Meaning, government treasury is wealth of all the members of the society and should not be subject of financial risk or investment of some individuals.<sup>219</sup>

Part of the criticism is also in relation to interest rate as benchmark. Although the interest rate is only used for pricing, the close link between interest-based pricing and usury is a great concern to Shari'ah scholars.<sup>220</sup> Vogel and Hayes for example pointed out that Islamic scholars do not recognise any difference between nominal and real rates of return.<sup>221</sup> In trying to address this issue Mirakhor suggested a procedure that utilises a calculation of the cost of capital and investment without resort to a fixed and predetermined interest rate.<sup>222</sup> One of the major consequence of prohibiting riba (interest) of course is that equity financing becomes the main source of financial capital, making the financial system becomes one that is equity-based.

---

<sup>218</sup> Islamic Fiqh Academy, *Majallat Majma' al-Fiqh Al-Islamic*. See also, Al-Amine, M.B.M. (2001), "The Islamic bond market: Possibilities and challenges", *International Journal of Islamic Financial Services*, (3), 1.

<sup>219</sup> Al-Shibali, Yousouf Abdullah (no date), *Al-Khadamat al-Istithmariyyah Fi al-Masarif Wa Ahkamuha fi al-Fiqh al-Islami*, vol.2 pp-140-147.

<sup>220</sup> Sen, P.M.(n.d.), "The Malaysian Islamic bonds market: An investigation of *Sukuk* and avenue of possible enhancement".

<sup>221</sup> Vogel, F. E. and Hayes, S. L. (1998), *Islamic law and finance: Religion, risk and return*, *Kluwer Law International*, The Hague.

<sup>222</sup> Mirakhor, A. (1996), "Cost of capital and investment in a non- interest economy." *Islamic Economic Studies*. (4), 1, 35-46.

While there other conventional criticisms to Islamic leasing for being a complicated concept with a limited scope for business, the product has expanded over the years, becoming the most popular form of Islamic finance.<sup>223</sup> There are Western banks offering Islamic instruments, and the funds were raised from both Muslim and non-Muslim investors.<sup>224</sup>

#### **(d). Istinsa**

*Istinsa* is a pre-delivery financing and leasing structured mode that is mainly used for to finance long-term mega projects i.e. the construction of a power plant.<sup>225</sup> The financial institution could either own the project, charge the lessee project company certain amount of fee-based on profits, or sell the plant to the project company on a deferred basis with a profit mark-up which is similar to a Murabaha.<sup>226</sup> There is however a distinction here with Murabaha, because in *Istinsa* contract, certain expenses that cannot easily be reflected in a sale and purchase agreement may be included in the fees payable to the financial institution by the project company.<sup>227</sup>

#### **(e). Takaful**

The Takaful is an older form of insurance under Islamic law. However, its contemporary development into modern institution first introduced in Sudan in the late 1970s and later Saudi Arabia. In a Takaful contract, participants pay instalments into a fund and the bank acts as managing trustee.<sup>228</sup> This is a form of Islamic insurance but it comes with a lot of controversy on whether it is allowed under the Shari'ah. Principally, insurance has always been a debated issue in Islamic financing.<sup>229</sup> But unlike interest products, people have not always had an alternative recourse to

---

<sup>223</sup> Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10 (4), 155-199.

<sup>224</sup> Collett, N. 1995. "The Preferred Option." *Asset finance And Leasing Digest* 219:12. See also Islamic Banking Means Western Opportunity, Nurul Islam, Business Journal, August 4, 2008. See, <http://www.gallup.com/businessjournal/109360/islamic-banking-means-western-opportunity.aspx#!mn-business>.

<sup>225</sup> Segrado, C. (2005). Case study "Islamic microfinance and socially responsible investments". *Italy: MEDA Project*. See also, Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10 (4), 155-199.

<sup>226</sup> Ibid.

<sup>227</sup> Ibid.

<sup>228</sup> Maysami, R. C., and Kwon, W. J. (1999). An analysis of Islamic Takaful insurance: A cooperative insurance mechanism. *Journal of Insurance Regulation*, 18(1), 109.

<sup>229</sup> Merdad, H., Hasan, M. K., and Alhenawi, Y. (2010). Islamic versus conventional mutual funds performance in Saudi Arabia: a case study. *Islamic Economics*, 23(2).

insurance when financial products based on trading and dealing require that the assets be insured.<sup>230</sup> After years of research and debate, a model was developed which is seen by some scholars as permissible.<sup>231</sup> This is in form of Takaful or mutual insurance, where participants are the owners of the fund and if any among them suffers a catastrophe or disaster, he or she would receive financial benefit from a fund to help meet that loss or damage.<sup>232</sup>

But some Shari'ah scholars have raised concerns about the permissibility of Takaful.<sup>233</sup> The major areas of contention are the business models employed in the industry. First, they argue that standard insurance violates the prohibition of *gharar* (uncertainty) since the benefits to be paid depend on the outcome of future events which are unpredictable and uncertain at the time of entering into the contract.<sup>234</sup>

The second is the issue raised by scholars such as Ismail was that insurance has a close similarity with gambling.<sup>235</sup> In the sense that the amount insured is paid back to the insured only when certain events occur. And where the anticipated event does not occur, the insurance company keeps the premium. It is he argues, "like putting money in a pot and rolling the dice, the lucky winner takes the pot."<sup>236</sup> Yet, looking at insurance from a more comprehensive perspective, one may argue that it is modelled in a way to ensure that premiums are paid by parties and are sufficient to cover all claims and allow the insurer a margin for profit. Where claims exceed the premiums and costs of running the scheme, the premium is subsequently increased to cover anticipated future cost. As will be seen later, some Islamic scholars have come to the conclusion that Insurance is permissible under Islam.

A third argument is that most insurance companies collect premium and reinvest them in businesses that engage in usury. Even though insurers have ethical policy in relation

---

<sup>230</sup> Wahab, A. R. A., Lewis, M. K., and Hassan, M. K. (2007). Islamic takaful: Business models, Shari'ah concerns, and proposed solutions. *Thunderbird International Business Review*, 49(3), 371-396.

<sup>231</sup> Othman, M. S., and Abdul Hamid, M. (2009). A study on the level of knowledge and understanding among muslims towards the concepts, arabic and Shari'ah terms in Islamic insurance (Takaful). *European Journal of social sciences*, 10 (3), 468-478.

<sup>232</sup> Wahab, A. R. A., Lewis, M. K., and Hassan, M. K. (2007). Islamic takaful: Business models, Shari'ah concerns, and proposed solutions. *Thunderbird International Business Review*, 49 (3), 371-396.

<sup>233</sup> Ibid.

<sup>234</sup> Ibid.

<sup>235</sup> Ismail, A. (April/May, 1998). Insurance and Shari'ah (2/2) takaful: A practical alternative. Nida'ul Islam, in Wahab, A. R. A., Lewis, M. K., and Hassan, M. K. (2007). Islamic takaful: Business models, Shari'ah concerns, and proposed solutions. *Thunderbird International Business Review*, 49 (3), 371-396.

<sup>236</sup> Ibid.

to their investment and measures could be put in place to prevent reinvesting in products forbidden under Islamic law, Shari'ah scholars are wary of issues on long-term insurance policies such as life insurance where the premium almost certainly is reinvested by the insurance company.<sup>237</sup> For example, in 1995, Sheikh Al-Azhar Al-Sheikh Jad-al Haq Ali Jad al-Haq of Egypt declared all life insurance to be prohibited under Shari'ah.<sup>238</sup> This position is clearly to avoid the potential of using investment, or premium to be reinvested in an unlawful investment contract for which the person paying the premium has no knowledge of. Yet, Prof. Mustafa Al-Zarqa, in his scholarly work on insurance arrives at a verdict of permissibility of all types of insurance, including life insurance.<sup>239</sup> He points out that insurance inevitably involves an element of *gharar*, which means the sale of an "undefined" or unspecified product. However, he explains that it is rather marginal, and as such it is overlooked, as in other types of transactions involving marginal *gharar*.<sup>240</sup> In conclusion, he stated that the insured should make sure that the insurance company invests in legitimate business. If the insurance company invests in any type of business forbidden in Islam, then taking out its policies becomes forbidden as a result.<sup>241</sup> Going by these one may argue that scholars are not unanimous on the position of insurance under Islamic law. Taking out the elements of *gharar*, and reinvestment of premium in a usury free venture, insurance may come within the permissible. Yet, in a world where companies and investments are becoming globally interconnected, such guarantee is very thin.

#### (f). Qard Hasan

This is arguably the oldest form of financing referred commonly as "Benevolent Loan". *Qard Hasan* is a loan where the borrower is required to only repay the original amount

---

<sup>237</sup> Khan, M. M., Alam, H. M., Ahmad, N., Iqbal, M. S., and Ali, S. (2011). Comparative analysis of Islamic and prevailing insurance practices. *International Journal of Business and Social Science*, 2(10), 282.

<sup>238</sup> Billah, M. M. (2001). Principles and practices of *Takaful* and insurance compared. Malaysia: GECD Printing Sdn. Bhd.

<sup>239</sup> See Adil Salihi Permissibility of Life Insurance Arab News, 02/09/2004. See, <http://www.aljazeeraah.info/Islam/Islamic%20subjects/2004%20subjects/February/Permissibility%20of%20Life%20Insurance,%20Adil%20Salahi.htm>.

<sup>240</sup> *ibid*

<sup>241</sup> *ibid*

and nothing more.<sup>242</sup> Although it is not common with commercial banks, it is among the oldest forms of Islamic financing. It has its roots in the principles of compassion and piety as embedded in the Holy Qur'an. The idea of *Qard Hasan* resides in the Islamic philosophy of alleviating financial hardship for people in difficult situations.<sup>243</sup> It is generally referred back to the provisions of the Qur'an "He who will give Allah *Qard al Hasan*, which Allah will double into his credit and multiply many times. Qur'an 2: 245. If you give Allah *Qard al Hasan* He will double it to your credit and he will grant you forgiveness. Qur'an 64:17. In another hadith reported by Abu Hurairah (R), the Prophet (s.a.s) said, "whoever relieves a believer from a difficulty in this world, Allah will relieve him from his difficulty and Allah will facilitate him in this world and world hereafter."<sup>244</sup> These according to some observers are contracts that do not present value to the lending institution. Hence, they are not very common.

### 3.4 Alternative innovations in futures and bonds commodities

The modern capital market has enjoyed a great deal of patronage of futures and derivatives. The Islamic capital market however is not involved deeply in these trades as overwhelming opinions by Islamic jurists is that practices in futures markets contradict the principles of Shari'ah. Some scholars have since advocated for an alternative contract in bonds that is inclined to the principles of *Al-salam* contract. Although little has been done on how the structure of these contracts and the rights and privileges of investors can be defined, there are efforts put in place in this direction. Scholars such as Ayyash and Rodney have made attempts to cover this area.<sup>245</sup>

The attempt was to introduce into the system the idea of bonds or futures to explore possible reform and replacements of the impermissible elements of commodity futures by having alternatives that can suit the Shari'ah principles. The bottom-line however is that any such product should not have the character of *gharar* (uncertainty) or be speculative in nature. In general, Islamic finance prohibits any transaction that has the characteristic of gambling or that which is embedded in uncertainty, but supports clear

---

<sup>242</sup> Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10 (4), 155-199.

<sup>243</sup> Ibid.

<sup>244</sup> Sahih Muslim

<sup>245</sup> Ayyash, M. S. A. (2008). Shari [ah Alternatives to Non-Shari [ah Elements in Modern Commodity Futures Trading. *Islamic Capital Markets*, 147. See also, Wilson, R. (2013). The development of Islamic finance in the gulf cooperation council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.

and unambiguous trades. The main argument under Islamic law is to keep all aspects of market transactions simple and clear in ways that are less prone to manipulation. This may be difficult to achieve with the nature of today's futures that allow for sophisticated manipulations of the market.<sup>246</sup>

#### **(a). The legitimacy of bonds**

A contract in bonds usually entails investment in different products and services. This means that such activities may include businesses that are into usury, gambling or even alcohol related. All of which are not permitted under the Shari'ah. Other examples include companies that are highly leveraged and have huge bank debt, requiring them to seek refinancing through issuing bonds.<sup>247</sup>

Taking into context the principal idea behind conventional bonds, it is a way by which traders make capital gains as fixed-interest bond prices rise when variable market interest rates fall, and also receive interest when due. As Wilson maintains, this venture "is largely about exploiting interest rate developments and trading in paper that is usually unrelated to the value of any underlying asset."<sup>248</sup> Hence, it is regarded by Islamic jurists as a kind of business that entails *riba*, and also exploitative as it is not on corporeal property, but some paper estimations of risk and return. Therefore, it is forbidden under the Shari'ah. Muhammad Taqi Usmani, a prominent Islamic jurist emphasise the legitimacy of very Islamic finance lies in it being for funding trade or real estate.<sup>249</sup> Merely funding the purchase of financial securities would involve second-order financing which is similar to lending for futures. This subsequently becomes speculative and comes with increased uncertainty (*gharar*).

In search of an alternative to the ever expanding world of futures, Islamic scholars first began exploring what is referred to as the concept of *Al-salam* contract. This means that a bond issued under Islamic finance has to be specifically earmarked and not declared and used for general unspecified purposes.

The literal description of *Al-salam* refers to future sale, where a seller undertakes to supply a specific commodity to the buyer at a future time and the buyer advances

---

<sup>246</sup> See for example *Davidson & Tatham v FSA* [2006] UKFSM FSM031.

<sup>247</sup> Ibid.

<sup>248</sup> Ibid.

<sup>249</sup> Usmai, M. T (2002). *An Introduction to Islamic Finance*. The Hague: Kluwer Law International.

payment for the price of the goods. The earliest records of *Al-salam* contract were with Muslim farmers, who engaged in this type of contract to receive cash advances to deal with immediate needs pending the period of harvest. In general, the buyer makes payments that are mostly less than the amount that would have to be paid if the buyer is to buy the commodity at the time and not in the future.

There are however certain conditions to *Al-salam* contract, which include an instant payment in full for the product. Secondly, this contract is only permissible for commodities that are standardised, and where the quality and quantity are measured exactly, commonly referred to as 'fungibles'.<sup>250</sup> Example of earlier contracts of *Al-salam* include the purchase of grains such as wheat, rice etc. But modern scholars believe *Al-salam* can be used for commodities such as oil, iron ore or copper, or indeed even electricity supplies that can be measured in kilowatts.<sup>251</sup> Other suggest that it can be used for contracts as simple as purchase of airline ticket.<sup>252</sup> The strict conditions for *Al-salam* are similar to other contracts as it does not permit contracts that attract usury, uncertainty and gambling.

Like many commodities in the capital market, there has been debate on the permissibility of exchanging the rights to commodities sold on the basis of *Al-salam*. On this, most Islamic scholars agree with the position of Ibn Taimiyyah, being one of the most prominent Islamic scholars of all time, that such exchanges are permissible on the condition that at the time of sale (selling the certificate), the price at which the certificate was sold is not higher than the agreed original.<sup>253</sup> Scholars such as Homoud added that it is not permissible to resell the commodity covered by *Al-salam* contract before receiving it, but the recipient has the permission to resell the commodity by another contract parallel to the first one, which could be at any price that such buyers are willing to pay.<sup>254</sup>

---

<sup>250</sup> Wilson, R. (2013). The development of Islamic finance in the gulf cooperation council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.

<sup>251</sup> Adam, J. N and Thomas, A. S (2005) *Islamic Bonds: Your Guide to Issuing, Structuring and Investing in Sukuk*. Euromoney Books, London.

<sup>252</sup> Ibid.

<sup>253</sup> Islahi, Abdul Azim, *Economic Concepts of Ibn Taimiyah* (Leicester: The Islamic Foundation, 1988), pp. 75–102. See also Wilson, R. (2013). The development of Islamic finance in the gulf cooperation council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.

<sup>254</sup> Homoud, Sami, 'Islamic financial instruments based on intermediary contracts', *Islamic Financial Instruments for Public Resource*. See also, Vogel, Frank, and Samuel Hayes, *Islamic Law and Finance: Religion, Risk and Return* (The Hague: Kluwer Law International, 1998), p. 146. See also Wilson, R.



The first ruling on the legitimacy of bonds under the Shari'ah was in 1988 when the Fiqh Academy of the Organization of the Islamic Conference on the request of Islamic economists. But before that period, *Mudaraba* certificates were first issued in Pakistan in 1980 under an ordinance and companies were allowed offer bond certificates to the public.<sup>255</sup> The failure of these bonds was partly due to the country's weak economy. The Jordanians and Bank Misr of Egypt have issued *Mudaraba* bonds but there were controversies with regards to the possibility of mixing funds and the guarantees of the bond principal, which essentially violates the Shari'ah principles.<sup>256</sup>

In the ruling given by the Fiqh Academy, they stated that Islamic investment certificates can be issued subject to proper legal documentation:

- That any collection of assets can be represented in a written note or bond.
- That this bond or note can be sold at a market price provided that the composition of the group of assets represented by the security, consists of a majority of physical assets and financial rights, with only a minority being cash and interpersonal debts.

This position by the Academy was influenced by the scholarly interpretation of the meaning of the provision of the Holy Qur'an in 2:282:

“When ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing. ...It is more just in the sight of God, more suitable as evidence and more convenient to prevent doubts among yourselves.”

Hence, the idea of Islamic market products based on futures were brought into discourse.

### **(i). Ijarah bonds**

*Ijarah* contract is generally a leasing agreement but unlike conventional lease, it has restricted principles mainly to guard the contract from uncertainties. Scholars suggest that since *Ijarah* contracts are for a predetermined future period, then it is suited to be

---

(2013). The development of Islamic finance in the gulf cooperation council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.

<sup>255</sup> Shallah, R. A. (1989) Islamic banking in an interest-based economy: a case study of Jordan. Durham theses, Durham University. See, Durham E-Theses Online: <http://etheses.dur.ac.uk/948>

<sup>256</sup> *ibid*.

arranged as a bond and be covered by certificates. *Ijarah* as Rodney states represent the ownership of well-defined assets subject to a lease contract, tradable in secondary market at the prevailing price determined by market forces and the certificates or securities represent a proportionate ownership claim over a leased asset.<sup>257</sup> Therefore the holder of the securities have ownership responsibilities that can only be terminated at the maturity of the securities, or at a point when they are sold to another party who then assumes the responsibilities. But unlike shareholders in conventional equity of a joint stock contracts holders of an *Ijarah* certificate are for a fixed period. The one advantage that an *Ijarah* bond presents is that it is less risky as the income stream is for a fixed regular amount, compared with equity investment, where the return can be subject to variation.<sup>258</sup>

## **(ii). Istisna bonds**

*Istisna* is generally used as a means of financing mega projects where the financing body advances funds for the project and is repaid from the income or revenue derived from the project. *Istisna* is therefore a contract that can be traded through bonds. Alternatively referred to as the “Islamic project bond”, it developed into a particularly useful tool in the Islamic funding of the construction phase of a project. It is often regarded as similar to a fixed-price ‘turnkey’ contract that enables investors to receive a return from the assets or project. Shari’ah scholars have permitted the use of such forward lease arrangement (known in some quotas as *ijara mawsufah fal-dimmah*). For example, The Qatar Real Estate Investment Company (QREIC) *Sukuk* offering in 2006 has elements of *Istisna* in its structure, and was listed on the Euro MTF market of the Luxembourg Stock Exchange. The 2008 issue of a second *sukuk* by National Central Cooling Company (*Tabreed*) also has an *Istisna* and is listed on the London Stock Exchange.<sup>259</sup> The most significant of course is the issue of *Sukuk* by HM Treasury in June 2014, which was the first country outside of the Islamic world to issue a *Sukuk*. The issue was up to £200 million and was 11.5 times oversubscribed while also priced

---

<sup>257</sup> Ibid.

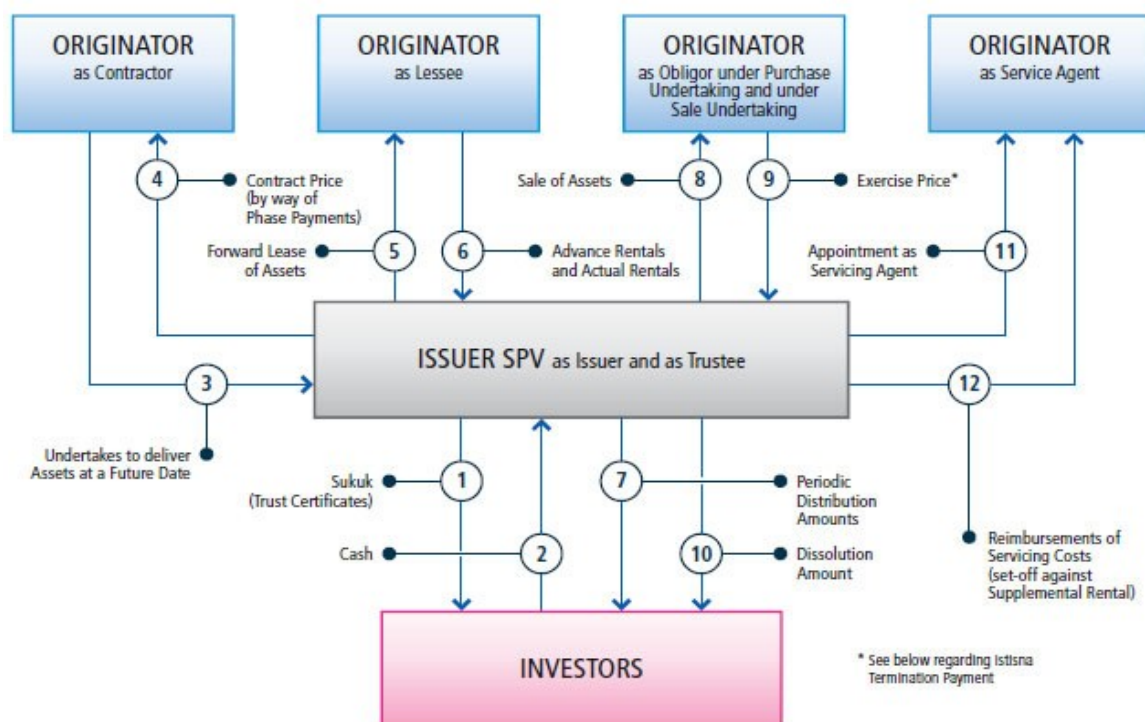
<sup>258</sup> Dusuki, A. W. (2010). Do equity-based Sukuk structures in Islamic capital markets manifest the objectives of Shari’ah? *Journal of Financial Services Marketing*, 15(3), 203-214. See also Wilson, R. (2013). The development of Islamic finance in the gulf cooperation council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.

<sup>259</sup> Dubai International Financial Centre Sukuk Guidebook. See, also <http://www.islamicbanker.com/education/Sukuk-al-Istisna>

at the equivalent UK government bonds (Gilts).<sup>260</sup> On what *Istina* connotes, Rodney states:

“The public authority or private company commissioning the project provides details of the specifications and timing of the schemes. The financier then sets these out in the tender documents. Bids are subsequently invited from contractors who will specify how they intend to sell completed parts of the project over time and the amount of each payment instalment expected. These instalments will include an element of profit over the construction costs. As the financier is expecting a stream of payments over a specified period, certificates can be issued based on the income expected.”<sup>261</sup>

### 3.4.1 The structure of Istisna bond.



Source, Dubai International Financial Centre (DIFC)

<sup>260</sup> See,

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/343686/UK\\_Sovereign\\_Sukuk\\_PL\\_COffering\\_Circular.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/343686/UK_Sovereign_Sukuk_PL_COffering_Circular.pdf). See, <https://www.gov.uk/government/news/government-issues-first-islamic-bond>.

<sup>261</sup> Wilson, R. (2013). The development of Islamic finance in the gulf cooperation council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.

The DIFC also gave a possible refinement in respect of the *Sukuk Al-istisna* structure.<sup>262</sup>

- If legal and/or registered title to a particular asset exists and (due to, by way of example, the prohibitive cost implications or tax implications of registering such a transfer of title) it becomes impossible to transfer that legal/registered title, it may be possible, depending on the asset type and the view taken by the relevant scholars of Shari'ah, to rely upon the concept of beneficial ownership in structuring a *Sukuk al-istisna* transaction. The *Istisna* agreement (in the structure discussed above) would document the transfer to the trustee of the beneficial ownership interest in the underlying asset, and such beneficial ownership interest would be sufficient to enable the trustee's enter into a forward leasing arrangements.
- Going by the view of some Shari'ah scholars who regard the *Istisna* arrangement as one that has to be entered into strictly between the purchaser and the contractor, the contractor has to be the person who will actually construct or manufacture the asset. Based on this approach, the Trustee would be required to have a relationship directly with the ultimate contractor/manufacturer and not the Originator. In order to avoid the difficulties of such an analysis, it may sometimes be necessary to re-characterise the *Istisna* arrangement as a procurement arrangement, whereby the Originator is obliged to procure the construction or manufacture and delivery of the underlying asset. The Originator thereby retains the direct contractual relationship with the ultimate contractor or manufacturer.

It should be noted however that under this guideline and arrangement, deferred price certificates represent debt obligations and cannot be traded for cash at below face value in a secondary market.<sup>263</sup> Scholars however pointed out that, they can be used to purchase goods or services whose price is equal to the face value of the certificate and permission must be sought from the original debtor in the event the debt contract is to

---

<sup>262</sup> Dubai International Financial Centre Sukuk Guidebook. See also <http://www.islamicbanker.com/education/Sukuk-al-Istisna>

<sup>263</sup> Wilson, R. (2013). The development of Islamic finance in the gulf cooperation council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.

be transferred from the financier to the supplier of goods and services.<sup>264</sup>

### **(iii). Mudaraba and Musharaka bonds**

Other alternatives include the potential for the development of both *Mudaraba* and *Musharaka* bonds.<sup>265</sup> By far, *Mudaraba* contract has been one of the most successful Islamic financing in terms of investment deposits with Islamic bank, where profits are calculated annually based of returns.<sup>266</sup> Proponents are looking at the possibility having well developed *Mudaraba* bonds to be designated as notes and their returns will be variable rather than fixed.<sup>267</sup>

It is suggested that holders of *Mudaraba* notes are not to have same rights and benefits as equity investors as they are only entitled to a profit share and there is no provision for capital gains based on the market valuation of the company.<sup>268</sup> Although the value of their notes cannot be guaranteed, it is the shareholders rather than *Mudaraba* note holders who are more likely to suffer from capital losses in the of companies loss.<sup>269</sup> But where the company goes bankrupt, it is the note holder that would hold a ranking prior to be in a higher equity investors, who may lose all of their investment.<sup>270</sup>

*Musharaka*, which is in form of partnership, has been a subject of bonds for years. For example, Sudan and Iran have launched *Musharaka* securities by issuing notes.<sup>271</sup> But scholars argue that there is still much room for the development of these contracts which needs clearly defined rights and privileges of certificate holders in relation to their counterpart equity investors.<sup>272</sup>

---

<sup>264</sup> Muhammad al-Amine, Muhammad al-Bashir (2010). 'The Islamic bonds market: possibilities and challenges', *International Journal of Islamic Financial Services*, (3), 1, 1–18.

<sup>265</sup> Said, D. (2007). Does the Use of *Sukuk* (Islamic bonds) Impact Islamic Banks Performances? A Case Study of Relative Performance during 2007-2009. *A Case Study of Relative Performance during, 2009*.

<sup>266</sup> Abdalla, M. G. E. (1997). Partnership financing for small enterprise-Problems and suggested improvements. In *Partnership Financing for Small Enterprise-Some lessons from Islamic credit systems* (Vol. 56, No. 61, pp. 56-61). Practical Action Publishing in association with GSE Research.

<sup>267</sup> Ellis, T. R. (2012). The Piety Premium of Islamic Bonds. *Middle East Quarterly*.

<sup>268</sup> Wilson, R. (2013). The development of Islamic finance in the gulf cooperation council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.

<sup>269</sup> Said, D. (2007). Does the Use of *Sukuk* (Islamic bonds) Impact Islamic Banks Performances? A Case Study of Relative Performance during 2007-2009. *A Case Study of Relative Performance during, 2009*. See also, Wilson, R. (2013). The development of Islamic finance in the gulf cooperation council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.

<sup>270</sup> Ibid.

<sup>271</sup> Yasseri, Ali, 'The experiences of the Islamic Republic of Iranian *Musharakah* financing', *Arab Law Quarterly* (1999), pp. 231–244.

<sup>272</sup> Ibid.

### 3.5 Conclusion

Many Islamic jurists are critical of a financial system that adopts or mimics Western-style practices, especially those practices that encourage lending money at interest.<sup>273</sup> Yet, many others in the Islamic financial community view western financial models as an opportunity for strengthening the outreach and significance Islamic financial system to benefit from modern market innovations.<sup>274</sup> Other scholars however insist that the Shari'ah model should be seen instead as an alternative to the ever fragile western model, and some of the less transparent and complex financial products and services.<sup>275</sup> To a certain degree, this contention has proved its legitimacy owing to the fact that the avoidance of complex and less transparent financial products that evolved over the years in western regimes have come with an equally high-risk investment causing the market to become vulnerable and forcing regulators to constantly monitor the market and review their regulatory framework. But scholars such as Bianchi argue that the dominant Muslim indictment of today's Islamic financial system is that "it has become addicted to legal formalism and contractual subterfuge", losing sight of the higher goals and intentions that law and economics should promote.<sup>276</sup>

It is also important to state that Islamic financial principle is one that often resist complex structures and products. This could be argued as an attribute of a system that insist on understanding form and substance, and also the deep emphasis on fairness over profit, and on what is deemed as an appropriate way of wealth distribution. These of course may not be the goal it may seem not in line with some of the goals and profit objectives of modern capitalist markets. It is also important to stress that, the presence of these complex products and the acute motivation on profit instead of fairness has seen many investors and economies of states suffering enormously from avoidable financial crash and crunch. Where international regulators demand greater honesty and disclosure, genuine Islamic financial regulators should not just comply, but promote the

---

<sup>273</sup> El-Gamal, M. A. (2003). Interest and the paradox of contemporary Islamic law and finance. *Fordham International Law journal*, 27, 108-149.

<sup>274</sup> Bianchi, R. R. (2006). Revolution in Islamic Finance. *The Chicago Journal of International Law*, 7, 569-580, p573.

<sup>275</sup> Kuran, T. (1997). The genesis of Islamic economics: a chapter in the politics of Muslim identity. *Social Research*, 301-338; Chapra, M. U (2004) Mawlana Mawdudi's Contribution to Islamic Economics. *Muslim World*, 94, 163-180.

<sup>276</sup> Bianchi, R. R. (2006). Revolution in Islamic Finance. *The Chicago Journal of International Law*, 7, 569-580, p573.

idea against any convention that allows for people to be exploited through practices and regulations enforced by the system itself.<sup>277</sup>

For Islamic financial service, the challenges are enormous and so are the opportunities as it has always been a blend of business and religion working to balance changing circumstances. While the expansion of Islamic finance presents many specific challenges, the most crucial is the way Islamic financial scholars draw a paradigm that appeals to both Islamic and non-Islamic communities. This, may be a challenging task, yet, with a rising middle class? in both the Far Asia and the Middle East, there is the room for the mass market that can be exploited by Islamic financial institutions.<sup>278</sup> Evidently, new demand for Islamic financial services is springing from thousands of local communities across the world, forcing financial administrators, regulators, and jurists to improvise ideas and solutions that best suit these unique and changing circumstances.<sup>279</sup>

If such ingenuity will become increasingly indispensable as Islamic finance grows, it is the ingenuity of Islamic financial scholars that would determine the extent to which this system will succeed in exploring and taking the opportunities of mass markets, especially in the emerging economies of Asia and Africa. Bianchi for instance points to how Islamic bankers who are spearheading the drive toward consumer finance are vigorously marketing their products and services to non-Muslims in pluralistic regions such as South and Southeast Asia.<sup>280</sup> Inevitably, she said, “the already porous lines between Islamic and western banking will be redrawn countless times in many different environments.”<sup>281</sup> In the midst of these overreaching changes and developments, Islamic financial service providers have found the opportunity keep up with the evolving practices and products in ways that do not breach the core principles embedded in Shari’ah while trying to conform with certain conditions imposed by transnational regulators through flexibility in the choice and structure of products and services. As much as western bonds comparatively easy to price, the issue of interest

---

<sup>277</sup> Siddiqui, S. H. (2001). Islamic banking: true modes of financing. *New Horizon*, 109, 15-20.

<sup>278</sup> Bianchi, R. R. (2006). Revolution in Islamic Finance. *The Chicago Journal of International Law*, 7, 569-580, p576.

<sup>279</sup> Jaffer, S. (2005). *Islamic retail banking and finance: global challenges and opportunities*. Linnius.

<sup>280</sup> Bianchi, R. R. (2006). Revolution in Islamic Finance. *The Chicago Journal of International Law*, 7, 569-580, p576.

<sup>281</sup> Ibid.

rates and inflation, the counterparty risk of the borrower being unable to pay in which case the interest will keep accumulating, is of great concern to Islamic jurists. For western style of equities, they are less transparent because there is less information about how the business is doing. However, it is important to also state that Shari'ah compliant asset-backed bonds may not be as transparent and may be subject to an element of market manipulation as equities are. All of these are challenges that future reforms of the Saudi Market will face.



## Chapter Four

### Market Abuse: A theoretical perspective

#### 4.1 Introduction

Theories and philosophical juxtaposition do not always define the dynamics of practical trajectories. This is even more so when it comes to the realities of a financial market where different products and services are traded in large numbers and various ways, by a large number of people across continents. Yet, the relevance of these theories in explaining many aspects of the market cannot be ignored. In the field of research into these dynamics, Easton once argues that whenever research is carried out, the researcher assumes the subject ontologically and the explanations epistemologically.<sup>282</sup> Therefore, a theoretical discourse becomes relevant in, at least, laying the foundation for what markets should or ought to be and in justifying or rejecting any concept.<sup>283</sup> Theories also dissect the challenging and complex structure of the market phenomena and reveals areas of convergence and divergence between philosophical principles and practical realities of the market.

Like other aspects of the human society, the development of the market economy is a transition with different starting points in different parts of the world. Modern financial markets have seen a surge in regulatory regimes imposed by governments, which in a way counters some famous classical western thinking of economists such as Adam Smith, Thomas Malthus, and John Stuart Mill who supported the theory that markets function best without government interference. Contemporary development on the other hand has shown that governments have become more proactive in regulating markets, making regulatory agencies become key components of markets all over the world.

While these conventional western theories discuss the different complex relationships between markets, individuals and the government, Islamic market philosophy postulates a unique nexus of contracts among the individual and the society based on divine laws.

---

<sup>282</sup> Easton, G. (2002). Marketing: a critical realist approach. *Journal of business research*, 55(2), 103-109, p103

<sup>283</sup> Ibid.

Arguably, the most fundamental underpinning of market in the Islamic world had been based on the basic kinds of trade and finances. But as markets continue to become more innovative, regimes influenced by Islamic principles such as Saudi were constrained to expand their products and services in order to compete and benefit from the opportunities in the global market. These are complex choices as there is the inherent need to maintain the tenets of Shari'ah in both finances and transactions. This has also brought the challenge of trying to build a legal framework that serves the priorities of this expansion. Most economic activities in regimes influenced by Islamic law are organised around this conception.

A major distinguishing factor between the two philosophies is that Islamic system does not often separate the sacred and the profane.<sup>284</sup> In many instances, these theories tend to suggest that manipulation of the market or abuse of privileged position or information to make gains is illegitimate. At the same time, some of these theories, especially that posited by Henry Manne were of the argument that not all acts that seemed manipulative or entail misuse of information for personal gain can be categorised as wrong.<sup>285</sup> They cautioned against a blanket judgement of these phenomena. Essentially, Manne being one of the earliest proponents of insider trading suggests that, insider trading in fact increases the efficiency of the market. This of course does not go down with the some of the right based and level playing field theories. These scholars advocate fairness in the market, but 'fairness' on its own may often be subjective term.<sup>286</sup>

Over time, the arguments against market abuse have come to dominate market structure and regulations, that today, the global market has almost unanimously converged on the notion that market abuse is an unacceptable behaviour and a punishable conduct. Hence, this chapter intends to discuss these aspects in light of conventional western theories and also from the perspective of theoretical principles of Islam. Essentially, the chapter would attempt to discuss the theoretical support as well as opposition to regulating markets and market abuse.

---

<sup>284</sup> Iqbal, Z., and Mirakhor, A. (2011). *An introduction to Islamic finance: Theory and practice*. John Wiley & Sons, p2

<sup>285</sup> Schotland, R. A. (1967). Unsafe at any price: a reply to Manne, insider trading and the stock market. *Virginia Law Review*, 1425-1478.

<sup>286</sup> Manne, H. G. (1984). Insider trading and property rights in new information. *Cato J.*, 4, 933.

## 4.2 Different strands of arguments about market abuse

There are philosophical, moral, religious and economic arguments on market abuse. While most argument reject market abuse in any form, there are also arguments on why some form of market abuse such as insider trading do contribute to the efficiency of the market.<sup>287</sup> Also, as the argument against market abuse looks overwhelming tilted towards the notion that it is illegitimate or, at least, unethical, some scholars argue that some forms of insider trading are perfectly legal.<sup>288</sup> Despite this difference in opinion, most literature is overwhelmingly tilted towards the notion that insider dealings and manipulations of trades are both unethical and morally wrong.<sup>289</sup> But then, there had been a series of historical debates among scholars in philosophy, law and economics as to whether such as an act ought to be penalised at all, especially where there is not clear victim. But the majority insists that market abuse is immoral and unethical and therefore should be punishable.<sup>290</sup> Those who have a contradicting view insist that using things like insider information for self-benefit at the expense of others is inherently unethical.<sup>291</sup> Adding to this old debate, McGee observes, “not all insider trading is unethical and some studies have concluded that certain kinds of insider trading are actually beneficial to the greater investment community”.<sup>292</sup>

### 4.2.1 Utilitarian approach

The scholarly discourse about market abuse from the context of utilitarian theory was largely the origin of other sub-theories such as the right-based approach and the famous socio-economic view on when an action or omission is good if the result is ‘the greatest good for the greatest number’.<sup>293</sup> Following this classical juxtaposition, other scholars

---

<sup>287</sup> *ibid*

<sup>288</sup> Shell, G. R.: 2001, ‘When Is It Legal To Trade on Inside Information?’ *MIT Sloan Management Review* (Fall).

<sup>289</sup> McGee, R. W. (2008). Applying Ethics to Insider Trading. *Journal of Business Ethics*, 77, 205-217

<sup>290</sup> Barucci, E. (2012). *Financial markets theory: Equilibrium, efficiency and information*. Springer Science & Business Media.

<sup>291</sup> Werhane, P. H. (1989). The ethics of insider trading. *Journal of Business Ethics*, 8 (11), 841-845. See also, Salbu, S. R. (1992). Misappropriation Theory of Insider Trading: A Legal, Economic, and Ethical Analysis, *The. Harv. JL & Pub. Pol'y*, 15, 223.

<sup>292</sup> *ibid*

<sup>293</sup> Bentham, J. (1843). A manual of political economy. *History of Economic Thought Books*; Director, A. (1964). Parity of the Economic Market Place, *The. JL & Econ.*, 7, 1.; Mill, J. S., & Lerner, M. (1965).

such as McGee also based their argument on whether the gains of a particular action exceed the loss.<sup>294</sup> This also relates us back to the question on whether such an act increases efficiency in the system or not. In all of these philosophical arguments, the notion is that if the benefit overrides the loss then the action may not necessarily be termed as a bad one.<sup>295</sup> Yet, it is important to look at this proposition alongside other situations in which the case is purely that of market abuse causing unwarranted and unjustified loss to others as a result of manipulation or fraudulent behaviour. Also argued McGee, the utilitarian position may also have to consider whether there was a breach of fiduciary duty in which case market abuse or insider trading may still be unacceptable even if it meets the utility test.<sup>296</sup> Hence, in market abuse, the utilitarian argument is one that considers aspects beyond the simple argument of good and bad.

The main distinguishing factor between the classical economic theory of markets and theories on market abuse and insider trading, is that, in classical theory, it is often impossible to precisely determine what is meant by gains and losses.<sup>297</sup> But in market abuse situations, what constitutes a loss is often in very clear terms. Another point raised by Rothbard is that, classical utilitarianism does not clearly give a cogent comparative analysis of interpersonal utilities, as different individuals place different values on things.<sup>298</sup> Instead, it is focused on the society. Essentially, the theory was not premised on the concept of individual violations of rights. Instead, what matters is whether the good outweighs the bad, meaning the end is what justifies the means.<sup>299</sup> The critic to this is when one looks at the fact that in market situations, the effect could sometimes be on an individual investor and not necessarily a whole group or class of market participants.

---

Essential Works of John Stuart Mill.; Brown, D. (1998). Economic Justice: The Market Socialist Vision. *Journal of Economic Issues*, 32(4), 1189-1193.

<sup>294</sup> McGee, R. W. (2010). Analyzing insider trading from the perspectives of utilitarian ethics and rights theory. *Journal of Business Ethics*, 91(1), 65-82.

<sup>295</sup> McGee, R. W. (2010). Analyzing insider trading from the perspectives of utilitarian ethics and rights theory. *Journal of Business Ethics*, 91(1), 65-82.

<sup>296</sup> *ibid*

<sup>297</sup> Williams, B. (1973). *A critique of utilitarianism*, in, Smart JJC, Williams B: *Utilitarianism: For and Against*. Cambridge University Press.

<sup>298</sup> Rothbard, M. N. (1997). The logic of action two. *Books*.

<sup>299</sup> McGee, R. W. (2010). Analyzing insider trading from the perspectives of utilitarian ethics and rights theory. *Journal of Business Ethics*, 91(1), 65-82.

There are schools that see insider trading from a very different perspective from the familiar argument of it being a bad aspect of market. In a study, Repullo attempts to show how insider trading was beneficial to some shareholders.<sup>300</sup> The problem here is that, both Manne and Rupello did not deny the fact that insider trading actually harms other category of investors. For example, Manne suggested that it does not have any significant effect on long-term investors. But then, one must also note that not all market participants are long-term investors. Again, Rupello's study also confirms that insider trading is beneficial to some shareholders, but that does not necessarily mean that it is harmless to other investors or to the financial system at large.

#### **4.2.2 The rights-based approach**

One of the theoretical polemics of market abuse, especially with regards to insider trading is the right-based argument which focuses on whether by acting in a particular way or using a particular information to make gains in the market is bound to violates another persons rights? On this, even some of the leading scholars that see insider trading as beneficial still agree that when an act violates another person's right, then such as act should be considered wrong.<sup>301</sup> In general, conventional western theories on markets and economics have both the mixture of utilitarian and rights-based approach. Laws and regulatory frameworks on the other hand, are largely focused on the protection of rights and investments. But laws could sometimes be a combination of two competing principles, i.e. to make the market more efficient, competitive, and profitable while at the same time protecting the investor. These competing philosophies often apply more to conventional system than Islamic ones due to the different complex products and services that could be volatile in terms of risk versus reward.<sup>302</sup>

Another aspect of the right-based theory is that it does not try to answer questions regarding the ethics of non-rights-violating behaviour, as it often relates to what some scholar's refer to as victimless crimes.<sup>303</sup> The same might be said about market abuse,

---

<sup>300</sup> Repullo, R. (1999). Some remarks on Leland's model of insider trading. *Economica*, 66 (263), 359-374.

<sup>301</sup> McGee, R. W. (2010). Analyzing insider trading from the perspectives of utilitarian ethics and rights theory. *Journal of Business Ethics*, 91(1), 65-82.

<sup>302</sup> Iqbal, Z., and Mirakhor, A. (2004). Stakeholders model of governance in Islamic economic system.

<sup>303</sup> McGee, R. W. (2010). Analyzing insider trading from the perspectives of utilitarian ethics and rights theory. *Journal of Business Ethics*, 91(1), 65-82.

which some earlier scholars may suggest is a victimless crime.<sup>304</sup> Essentially, Henry Manne's arguments for insider trading, which by far is seen as an abuse of market is that, it is a form of executive compensation for entrepreneurial efforts.<sup>305</sup> He also maintains that insider trading increases efficiency, which means it should be permitted. But scholars such as Salbu criticise this assertion on the grounds that giving some exclusively powerful members or entities within the market community access to information which can be used for personal benefit against all other market participants makes the market inefficient, it also makes the market an uneven playing field.<sup>306</sup> This philosophy of Salbu defines what modern market regulatory bodies envisage.<sup>307</sup> With the shifting dynamics of markets and the concern over risk, most of the old philosophies have been ignored by legislators. Instead, what is obvious with contemporary markets is the enormous amount of rules and monitoring by governments to ensure that investors are protected from unfair market behaviour. Governments are also interested in a safe market environment that has the prospect of attracting more investors and not pushing them away due to unfair lack of fairness and transparency.

The Pigourian theory for instance sees a market from a point distinct from classical economics and other theorists that often conceive economics as a science of wealth accumulation.<sup>308</sup> Instead, he portrays it as a science of analysing effects of alternative policies, spelling out their consequences for the size, distribution, and stability of the national dividends.<sup>309</sup> Although capital market is a convergence of both private and public, modern market comes with a strong government interference largely to protect the market in the interest of both the investor and the public. This often far-reaching government interference is mainly driven by the common idea that as custodians of public trust, government must ensure that the market is regulated and participants are protected from unfair market behaviour.<sup>310</sup> Avgouleas is a proponent of this argument, maintaining that governments should be allowed to regulate markets because left alone,

---

<sup>304</sup> Manne, H. G. (1969). Rejoinder To Mr. Ferber, A. *Vand. L. Rev.*, 23, 627.

<sup>305</sup> Manne, H. (1966) *Insider Trading and the Stock Market*. The Free Press, New York

<sup>306</sup> Salbu, S. R. (1989). A Legal and Economic Analysis of Insider Trading: Establishing an Appropriate Sphere of Regulation. *Business & Professional Ethics Journal*, 3-21.

<sup>307</sup> Salbu, S. R. (1992). Misappropriation Theory of Insider Trading: A Legal, Economic, and Ethical Analysis, *The Harv. JL & Pub. Pol'y*, 15, 223.

<sup>308</sup> Pigou, A. C. (2013). *The economics of welfare*. Palgrave Macmillan.

<sup>309</sup> Ibid.

<sup>310</sup> Ibid.

markets cannot regulate themselves.<sup>311</sup> However, he made reference to the extent of regulation that is logical and cautioned against stringent legislation. Many empirical studies he argues have shown that the modern capital market may often demand certain degree of free hand to function efficiently.<sup>312</sup> He gave example with short sales, which he says have proven beneficial because when they were banned in the US and the UK in 2008, it did not yield any benefits. Instead, it had adverse effects on liquidity. The best way he argues is to go with rules of disclosure such as the ones in the International Organisation of Securities Regulators IOSCO.<sup>313</sup>

The IOSCO has made a series of recommendations to regulators in to address the challenges posed by the significant technological developments in financial markets by ensuring that they do not impact negatively on market integrity and efficiency.<sup>314</sup> This recommendation calls on regulators to require that trading venue operators provide fair, transparent and non-discriminatory access to their markets and to associated products and services; to ensure that trading venues put suitable trading control mechanisms (such as trading halts, volatility interruptions, limit-up limit-down controls, etc.) to deal with volatile market conditions; all order flow of trading participants to be subject to appropriate controls, including automated pre-trade controls; assess the impact of technological developments in the market and regulate them to ensure integrity and efficiency and; to ensure that they monitor for novel forms or variations of market abuse that may arise as a result of technological developments and take action as necessary.<sup>315</sup>

There are however polemics on the economic arguments and the argument over fairness. While some scholars opined in dealing with the structure and behaviour of market participants and entities, that fairness and integrity should prevail even beyond economic arguments, while other suggest that economic arguments are superior to

---

<sup>311</sup> Avgouleas, E. (2010). A new framework for the global regulation of short sales: Why prohibition is inefficient and disclosure insufficient. *Stanford Journal of Law, Business, and Finance*, 16 (2).

<sup>312</sup> Ibid.

<sup>313</sup> Ibid.

<sup>314</sup> Winn, J. K. (1998). Regulating the Use of the Internet in Securities Markets. *The Business Lawyer*, 54(1), 443-458.

<sup>315</sup> International Organisation of Securities Regulators. Their recommendations for a model law on market abuse 2011. See, <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD361.pdf>.

moral arguments.<sup>316</sup> While these schools disagree on which of the arguments trumps the other, they were unanimous on the idea that market abuse or insider dealing is a negative aspect in financial markets.

#### **4.2.3 Level playing field theory**

The level playing field argument is among the most prominent in market theory. It has essentially influenced the many institutional changes and regulations seen across regions. Advocates of fair market from both conventional and Islamic regimes have advanced this argument and demanded that markets be regulated so that every participant can have a fair and level playing ground. The level playing field argument according to Lawson suggests that that buying and selling is unethical when the information is asymmetric.<sup>317</sup> However, looking at the way information is shared in the market and in the real world, it is almost all the times asymmetric, as some people have more information than others, and some get information quicker and faster than others.<sup>318</sup>

The level playing field argument has relevance in financial markets. It has been consistently used to justify the idea that all market participants must be protected from unfair deals for which information is either not fully given to them; used against them or certain aspects that may have effect on their investment is hidden from them. This is contrary to previous theories such as the ‘Comparative advantage’ notion of Ricardo (1871), who believes that it is unfair for individuals who have worked hard to make a system operate to have equal advantages with those that do not.

One of the major challenges of the level playing field theory is whether it is possible to ever have a level playing field in the realm of contemporary market with all its asymmetric information and the cumbersome nature of the regions and information’s that drive liquidity. Lekkas for example argues that players in the market are not all equal, which is why it is not always possible to have a level playing field.<sup>319</sup> Essentially,

---

<sup>316</sup> Ma, Y., & Sun, H. L. (1998). Where should the line be drawn on insider trading ethics?. *Journal of Business Ethics*, 17(1), 67-75.

<sup>317</sup> Lawson, G. (1988). Ethics of Insider Trading, *The Harv. JL & Pub. Pol’y*, 11, 727.

<sup>318</sup> Ibid.

<sup>319</sup> Lekkas, P. (1998). Insider trading and the Greek stock market. *Business Ethics: A European Review*, 7(4), 193-199.



this argument stresses that some market participants have more privileges and better information than others. But then, he further argues that, unrestricted, market participants are bound to engage in shady manipulation and greed that in the end affects the fabric of fairness that markets ought to have.<sup>320</sup> He made reference to the famous philosophy of Voltaire "one's liberty must be constrained at the point where it interferes with the liberty of another". Hence, any conduct by insiders to use information fraudulently for personal benefit at the expense of others should be regarded as a violation.<sup>321</sup> Where the person happens to be of professional or trust position, it should be seen as a breach of fiduciary duty. Yet, there are studies that support insider dealing such as Cornell and Surri,<sup>322</sup> and Chakravarty and McConnell who argue that insider trading should actually be seen as some form of compensation to company professionals, and that it promotes efficiency.<sup>323</sup> For market manipulation, it is generally seen as an unfair and unjustifiable conduct, often synonymous to cheating.

While the level playing field is largely based on public interest for regulating financial markets, Djankov *et al.*, oppose this idea, emphasising that despite the disadvantages that free market often presents, it is still more efficient than one which is tightly regulated by governments.<sup>324</sup> Other critics argue that the government does not always necessary works for the benefit of the society but to benefit itself. Stigler for example argues that the State, with its powers to compel or prohibit, has the potential to be a resource or threat to every industry in the society.<sup>325</sup> Another argument by Djankov *et al.*, is that some regulations have enormous effects on the industry for example cases of heavy taxation of products.<sup>326</sup> Paradoxically, this relationship also creates incentives where the state and the industry through regulatory frameworks become close in in relationship that it create situations where those who committed offences may not be adequately penalised. Despite these however, the regime of international market regulations has expanded over the years developing series of principles that regulate markets across

---

<sup>320</sup> Ibid.

<sup>321</sup> Ibid.

<sup>322</sup> Cornell, B., and Sirri, E. R. (1992). The reaction of investors and stock prices to insider trading. *Journal of Finance*, 1031-1059.

<sup>323</sup> Chakravarty, S., and McConnell, J. J. (1997). An analysis of prices, bid/ask spreads, and bid and ask depths surrounding Ivan Boesky's illegal trading in Carnation's stock. *Financial Management*, 18-34.

<sup>324</sup> Djankov, S., La Porta, R., Lopez de Silanes, F., and Shleifer, A. (2001). The regulation of entry.

<sup>325</sup> Stigler, G. J. (1971). The theory of economic regulation. *The Bell journal of economics and management science*, 3-21.

<sup>326</sup> Djankov, S., La Porta, R., Lopez de Silanes, F., and Shleifer, A. (2001). The regulation of entry.

countries. The IOSCO for example, developed a number of principles that guide the regulations of securities, protection of investors, transparency and fairness in markets.<sup>327</sup> Essentially, the IOSCO emphasises on international cooperation to ensure a better regulation of the markets, on domestic as well as on the international level, in order to maintain just and efficient markets. It also emphasises on exchange information and to establish standards and an effective surveillance of international securities transaction, while maintaining mutual assistance to ensure the integrity of the markets by a rigorous application of the standards and by effective enforcement against offences.<sup>328</sup> These propositions were seen as necessary to maintain efficiency in the market and to protect investors. Hence, governments have consistently enacted legislation and reviewed existing ones and maintained an international network of watchdogs.

Yet, as McGee argues, using the level playing field argument alone is insufficient to discredit insider trading. His argument was that, to debunk insider trading and punish those found to use privileged information for their gains, other justification must be found.<sup>329</sup> As McGee states:

“One party to the transaction often knows more about the value of the item being sold than does the other party. A knowledgeable antique collector knows more about the value of certain objects than does the owner of the property that is offering it for sale in a week-end yard sale. Acquisition and merger specialists know more about the underlying value of a company’s shares than does the average uninformed shareholder. Executives of a company often know more about the value of their company’s stock than do non-employees.”<sup>330</sup>

The possession of better information says McGee could be justified just as “forcing the insiders to give their property rights in information to outsiders just because the outsiders do not yet possess the information would be inherently unfair to the

---

<sup>327</sup> Sommer Jr, A. A. (1996). IOSCO: its mission and achievement. *Nw. J. Int'l L. & Bus.*, 17, 15.

<sup>328</sup> Ibid.

<sup>329</sup> McGee, R. W. (2010). Analyzing insider trading from the perspectives of utilitarian ethics and rights theory. *Journal of Business Ethics*, 91(1), 65-82.

<sup>330</sup> Ibid, p76.

insiders.”<sup>331</sup> But he went further to stress that, even as this could be true of minority of situations, it may not be justified in all cases.<sup>332</sup> It is therefore not justified to penalise these categories of persons because of their privileged knowledge which they may use in trading the financial market. However, some scholars still argue that even though trades cannot be free, they must be fair, and whatever that means.<sup>333</sup>

#### 4.2.4 Fiduciary duty argument

Moore believes that the fiduciary duty argument is the strongest argument that can be put forth to outlaw market abuse emanating from officials.<sup>334</sup> The underlying premise of the fiduciary duty argument is that officers and directors have some fiduciary duty to their shareholders, which requires them to fully disclose any and all significant information that shareholders could benefit from knowing.<sup>335</sup> The argument is good as far as it goes, but it has been criticised for being incomplete. The strongest criticism is that the fiduciary duty argument often applies only to officer and to outsiders or employees who have no fiduciary duty to shareholders. Other criticisms were on situations where it applies exclusively to insider trading. Especially the notion that any damage or loss caused to shareholders as a result of the act of employees or officials of a company through insider trading cannot be brought under the fiduciary duty argument. In the case of market manipulation which covers any transaction or behaviour which is likely to mislead other market participants in terms of price of commodity or otherwise, it is generally regarded as a criminal act.<sup>336</sup>

Strudler and Orts for instance brought up the debate over situations where companies allows their staff or directors to trade on certain privileged information.<sup>337</sup> Further, court decisions have held that it also exists for non employees and outsiders.

---

<sup>331</sup> Ibid, p76

<sup>332</sup> Ibid.

<sup>333</sup> Bovard, J. (1991). *The Fair Trade Fraud: How Congress Pillages the Consumer and Decimates American Competitiveness*. Palgrave Macmillan.

<sup>334</sup> Moore, J. (1990). What is really unethical about insider trading?. *Journal of Business Ethics*, 9 (3), 171-182.

<sup>335</sup> O'Hara, P. A. (2001). Insider trading in financial markets: legality, ethics, efficiency. *International Journal of Social Economics*, 28(10/11/12), 1046-1063.

<sup>336</sup> In recent times for example, the definitions of market manipulation have been widen to capture the growing innovative way through which people manipulate the market in ways that are difficult for authorities to even gather evidence.

<sup>337</sup> Strudler, A., and Orts, E. W. (1999). Moral principle in the law of insider trading. *Tex. L. Rev.*, 78, 375.

In the *Faccenda Chicken* case, the court held that the employee has a duty not to use information gained in employment to detriment of employer's business.<sup>338</sup> A similar case was the American case of *O'Hagan*, the U.S. Supreme Court held that the defendant acted unethically, despite the fact that he an outside who was only involved as a partner in a law firm involved in a company merger.<sup>339</sup> And he used the information available to him to trade in shares. The court held that the simple reason that the defendant is an outsider and not an insider in the company does not exonerate him from the liability of inappropriate market behaviour. It is also important to note that in this case nothing suggest that the defendant made any misrepresentation but he was still found guilty by the court for breaching fiduciary duty. Strudler and Orts criticise the opinion of the court as stretching the concept of fraud "beyond any easily identifiable limit."<sup>340</sup> The argument was that the definition of fraud was stretched by including an outsider who did not utter any misleading statements with the intent to defraud has been criticised as going too far.<sup>341</sup>

Other scholars also criticised this extension of the definition of fraudulent market behaviour, which they said should be limited to insiders and not outsiders. The problem with this argument of course is the fact that, when an outsider is by virtue of his profession or employment privy to insider information, then using such information to make gains similar to ones that insiders could make may not appeal to the proponents of market fairness. Langevoort also raised a question of whether there is a fiduciary duty to individuals who have stock options.<sup>342</sup> The position of some scholars to this question is that the relationship between employees and the corporation is based on contract and therefore involves no other obligation than to deliver according to the terms of the contract.<sup>343</sup>

---

<sup>338</sup> *Faccenda Chicken* [1987] Ch 117, [1986] 1 All ER 625.

<sup>339</sup> *United States v. O'Hagan*, [1997] 521 U.S. 642.

<sup>340</sup> Strudler, A., and Orts, E. W. (1999). Moral principle in the law of insider trading. *Tex. L. Rev.*, 78, 375., p381

<sup>341</sup> McGee, R. W. (2010). Analyzing insider trading from the perspectives of utilitarian ethics and rights theory. *Journal of Business Ethics*, 91(1), 65-82.

<sup>342</sup> Langevoort, D. C. (1982). Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement. *California Law Review*, 1-53.

<sup>343</sup> See Macey, J. R. (1984). From Fairness to Contract: The New Direction of the Rules Against Insider Trading. *Hofstra L. Rev.*, 13, 9.

#### 4.2.5 Fairness vs. fraud argument

Strudler and Orts maintain that the concept of fairness in the market is mainly a phenomenon that suggest how an act is morally unjustifiable is in respect of how it infringe the rights of persons affected by it, “and not merely the social welfare or the utility that the act produces.”<sup>344</sup> The fairness argument is closely related to the moral and the level playing field arguments. It is to the extent that any act that confers an unfair advantage on one party against the other in trade is illegitimate and unacceptable. A transaction is therefore only fair if when all parties have fair access to the market and the information necessary to allow them understand both risk and reward thereby making inform decisions i.e., the transaction is fair if the system would not allow one group to take unfair advantage of the other.<sup>345</sup>

In one of US’s Supreme Court decision, Justice Blackmun of the Supreme Court of the United States ruled that insider trading is inherently unfair.<sup>346</sup> Although the definition of fairness could often be subjective, contemporary laws of market across the world have made attempts to specify in clear terms what may amount to unfair and illegal market practice. Mainly, these acts are categorised under the regime of market abuse and are often punishable with sanctions. Some of the main reasons for drafting and redrafting market regulatory laws include the determination to make the market as fair to every participant as possible. As many products and services continue to emerge so are regulators enacting new provisions to check situations where people would take advantage of the products or services to manipulate or abuse the market by making unfair gains. What these categories of people or institutions do is to engage in some form of clandestine unethical market practices that often shift the risk in against the unsuspecting and vulnerable investor.<sup>347</sup> Hence, contemporary regulatory framework insist on fairness among all market participants and punish any act that was done to unfairly benefit from the vulnerability of other market participants.

The fraud argument on the other hand is that which denounces acts of making false pretence with the view and securing a practical result. It also includes cases where

---

<sup>344</sup> Strudler, A., and Orts, E. W. (1999). Moral principle in the law of insider trading. *Tex. L. Rev.*, 78, 375., p381

<sup>345</sup> Lawson, G. (1988). Ethics of Insider Trading, *The. Harv. JL & Pub. Pol’y*, 11, 727.

<sup>346</sup> Chiarella v. U.S., 1980 at 248. See also, U.S. v. Carpenter, 1986/ 1987

<sup>347</sup> Cho, J. Y., and Shaub, M. K. (1991). The consequences of insider trading and the role of academic research. *Business & Professional Ethics Journal*, 83-98.

parties are fed with with false or misleading information about market products or services.<sup>348</sup> The general theory is that while the law protects all parties, there is also the implied contract that all market participants should act in good faith. Although good faith may mean the willingness to ensure equal and sincere engagement with fellow traders, it is mostly defined as no more than the absence of bad faith. This absence of bad faith in business relationship has been used for centuries as a principal requirement in commercial transactions and in commercial laws.

#### 4.3. Islamic theory

Like in western scholarship, there exist Islamic philosophical theories on finances that are based on theological command laid down. Most of these are derived from the Qur'an and the Hadith. But as markets continue to be developed by new, sometimes complex products and innovations, these theories and rules are revisited to accommodate these emerging aspects. The core philosophies that guide markets regulations in Islamic world were those that emphasis on fair dealings based on the tenets of Shari'ah. The position of the Shari'ah on finance and markets is as stated: "Deal not unjustly, and you shall not be dealt with unjustly" Qur'an 2:279.<sup>349</sup> "Eat not up each other's property by unfair and dishonest means" Qur'an 4:29. "Give full measure and full weight in justice, and wrong not people in respect of their goods" Qur'an 11:85.<sup>350</sup> Hence, most theories regarding market in regimes that are influenced by Islamic doctrines tend to place emphasis on these as justification for regulation of market abuse. The main principles of the Saudi market regulation is to a larger extent built upon the concept of business ethics that are ingrained in the teachings of the Qur'an and the practice of Prophet Muhammad and ought to be a usual element of the Muslim way of conducting commercial transactions.<sup>351</sup> A fundamental principle of Shari'ah preaches that the sole purpose of man's existence is to seek the pleasure of his Creator. Thus, this perspective on life requires constant determination at all times trying to conduct oneself in a manner, which will please his Creator and to earn sustenance from Halal. Although the general idea of halal is mostly seen from the perspective of

---

<sup>348</sup> Strudler, A., and Orts, E. W. (1999). Moral principle in the law of insider trading. *Tex. L. Rev.*, 78, 375., p381

<sup>349</sup> The Holy Quran Translation by Abdullahi Yusuf Ali, 2001. See also Alserhan, B. A. (2015). *The principles of Islamic marketing*. Ashgate Publishing, Ltd..

<sup>350</sup> *Ibid.*

<sup>351</sup> McGee, R. W. (2010). Analyzing insider trading from the perspectives of utilitarian ethics and rights theory. *Journal of Business Ethics*, 91(1), 65-82.

food, the general concept encompasses all wealth and income. Insider trading is therefore seen to have no place in an Islamic stock market. One of the fundamentals of Shari'ah is accountability of the source of income, where such source involves immoral and illegal transactions, then the wealth is generally regarded as illegal.<sup>352</sup>

#### 4.3.1 Duty of the State in regulating market

Islamic principles generally allow for the state to interfere in all public affairs, including market transactions. This principle is contained in Qur'an, 43:24-32 that says, "We have allocated among them their livelihood in the worldly life, and have raised some of them over others in ranks, so that some of them may put some others to work."<sup>353</sup> This verse according Qazi shows that, while allocation of wealth is a prerogative of Allah the creator,<sup>354</sup> Allah also makes the forces of demand and supply as part of market organisation and allows for authorities to intervene in ensuring stability. In relation to state intervention, Jabir, one of the companions of Prophet Muhammad (s.a.w)<sup>355</sup> narrated that states that Islamic philosophy supports a free market in which market players determine how they want to deal with each other.<sup>356</sup>

But despite this emphasis on free market, Islam does not allow market participants' to invest in *Riba* (usury), Alcohol etc.<sup>357</sup> Usmani went further to identify three exceptions to this principles. They are as he mentioned the religious, the state and the moral restrictions.<sup>358</sup> The religious restriction he says is one that clearly disallows any transaction in any kind of product or services that is prohibited under Islam. The State restriction he says is one that places emphasis on allowing the market to run its natural course driven by the forces of demand and supply, which is what Islam dictates. But where their natural forces are distorted due to corrupt or unethical behaviour in the market, then the state has to interfere. The third principle is the one that puts morality

<sup>352</sup> 1<sup>ST</sup> Ethical Charitable Source. Halal Money Guide.

<sup>353</sup> The Holy Qur'an. Also see, Maidin, A. J. (2011). Islamic principles on sustainable land use planning and development. *Journal of Islamic Law Review*, 7(1), 57-89.

<sup>354</sup> Qazi, B. A. (2014). Shari'ah Rulings of Price Intervention (Tas' eer) and its Contemporary Applications. *In The Name of Allah, The most Beneficent, The most Merciful*, 11.

<sup>355</sup> Ahadith is one of various reports describing the words, actions, or habits of Prophet Muhammad. It forms part of the primary sources of Islamic law.

<sup>356</sup> Muslim, I. U (2000). *Sahih Muslim* (Vol. 6). Beirut: Dar El-Mareefah,

<sup>357</sup> Qazi, B. A. (2014). Shari'ah Rulings of Price Intervention (Tas' eer) and its Contemporary Applications. *In The Name of Allah, The most Beneficent, The most Merciful*, 11.

<sup>358</sup> Usmani, M. T. (2002). *Takmilah Fathul Mulhim* (Vol. 1). Karachi, Pakistan: Maktaba Darul Uloom Karachi.

as part of religious obligation. This includes morality and sincere conduct in market relationship. Morality he says is not separate from religion and they “should compete with each other in adding value to the collective welfare and satisfaction of needs of consumers rather than in maximising their profits.”<sup>359</sup> The unanimous position of Islamic jurist is that Shari’ah recognises the importance of allowing the market to determine price based on demand and supply forces.<sup>360</sup> It is, according to both Shafi’i and Hambali School of jurisprudence, impermissible for the state to impose prices because such act may amount to injustice.<sup>361</sup> But Islam still has regulations that permit the state to regulate price of commodities when it clearly appears that the sellers have substantially inflated the prices to an exponential excess of what it should be.<sup>362</sup>

The Maliki School even went further to suggest “it is not necessary for the permissibility of price intervention that price is substantially increased by the sellers. A nominal increase in price in inflationary period is enough to give the regulator the latitude to intervene in price.”<sup>363</sup> While the restriction on the seller to sell according to his wish is a violation of his or her rights to sell their assets for a mutually agreed price, such violation is tolerated in order to avoid economic imbalance from the whole society.<sup>364</sup> In general, intervention of the regulator to fix the prices is not a preferred act in normal circumstances but it is allowed to the extent that it becomes necessary to stabilise the market and overall economy.

#### **4.3.2 Principles on dishonesty in dealings and abuse of market**

Islamic perspectives on market abuse are largely centred on the morality, fairness and fiduciary duty narrative. In the sense that, it requires parties to be conscious of their responsibilities towards each other, and to deal with each other with fairness and honesty. Not to trick and not to defraud. The Shari’ah, which is the dominant prism through which the Saudi financial market regulations was conceptualised regard market

---

<sup>359</sup> Ibid, p315.

<sup>360</sup> Az-Zuhaili, W. (1985). *Al-Fiqhul-Islami-Wa-Adillatuhu*, Vol. 5 Damascus.

<sup>361</sup> Mansoor Ibn Yunus, A.-B. (2002). *Kashshaaf-ul-Qinaa'* (Vol. 3). Beirut: Dar-ul-Fikr.

<sup>362</sup> Al-Haskafi, A. D. (2000). *Ad-Durrul Mukhtar* (Vol. 5). Karachi: H.M.Saeed Company.

<sup>363</sup> Qazi, B. A. (2014). Shari’ah Rulings of Price Intervention (Tas’ eer) and its Contemporary Applications. *In The Name of Allah, The most Beneficent, The most Merciful*, 11, p14

<sup>364</sup> Ibn-un-Nujaim, Z. U. A. (2004). *Al-Ashbah Wan-Nazair*. Karachi: Idara-tul-Qur’an Wal- Uloom-ul Islamiyyah.



abuse as an immoral and illegal conduct and a breach of trust.<sup>365</sup> This is because, any person with insider information or with a professional and legal authority to such information is primarily regarded as someone in the position of trustee. Likewise, any transaction between parties is seen as one that should be governed by the '*Fiqh al Muamalat*' i.e., the principle of honesty in all human dealings. Essentially, Shari'ah law regards any earning through these means as dubious and therefore not permissible. The principle goes to state that, any earnings through such means of dubious act is so grave that a person's prayer and supplication may not be accepted.<sup>366</sup> Therefore, any fraudulent behaviour, trick, misrepresentation or misuse of such information for self-gain is a moral wrong under Shari'ah and a crime under the regulations of the Saudi capital market.

This strict prohibition by Islam on the money, which has been earned in a way, which is illegal also prohibits the possession and use of such money that though may be legal but has been obtained illegally. Therefore, the prohibition principally starts with the way in which it is obtained.<sup>367</sup> The majority of Islamic jurists are of the consensus that such gain, whether in stocks, bonds or other products is not permissible.

#### 4.4 Conclusion

Acts that amount to market abuse are difficult and sometimes complex to debate. These are issues that come with enormous polemics in theory and that cannot always be addressed. Perhaps there are theories that say some form of market abuse, can in fact be beneficial to the market system, this notion suggests that not all acts of insider trading are violations of rights. That in some cases, they may simply be an exercise of a property right. However, what is popular among contemporary scholars and professionals is that for markets to be safe and prosperous, regulations must be put in place to protect all parties. While it is true that in many instances of market abuse, there are people that profit, such profits and gains often come at the expense of others who lose money unfairly. Hence, the overwhelming theories, both of western conventional thoughts and Islamic jurisprudence tend to suggest that for markets to flourish, they

---

<sup>365</sup> Obaidullah, M. (2001). Ethics and efficiency in Islamic stock markets. *International Journal of Islamic Financial Services*, 3(2), 1-10.

<sup>366</sup> Febianto, I. (2009). Shari'ah Compliant Model of Business Entities. See, <http://www.wbiconpro.com/350-Irawan.pdf>.

<sup>367</sup> Al-Baz, A. (2004) *The rules of prohibited money and the rules of utilizing and using it in the Islamic law*. Jordan: Dar Al-Nafaes. p55-70.

have to be devoid of abuses and manipulations. It also has to be transparent enough for investors to understand their risk and reward in a way that allows them to make informed choices, and have the confidence that they would not be cheated or manipulated by others. Without such regulation on how information is used or abused, markets would certainly become vulnerable to unethical and prejudicial conducts that would result in other benefitting fraudulently at the expense of others or be used by those who have privileged information against others.

These notions of fairness in the market and transparency in service delivery are widely covered in western and Islamic scholarship. However, there are some philosophies in Islamic principles that distinguish it from conventional western theory. The theory of market activities in Islamic principles entails a philosophy of fair playing based on Islamic principles rather than level playing field. Essentially, it suggests that the idea of engaging in transactions of pleasing the creator through fairness to other parties, whereas in conventional western thoughts, the quality of one's behaviour is perceived as unjust only in relation to the other. Islamic philosophical thoughts connote both moral and social values, which include fairness and balance.

Alongside what may be contained in theory, scholars have made reference to how market abuse is unhealthy for both the market and the general economy. Hence, there is the constant requirement that regimes should make adequate laws to ensure that those responsible for abusing the market are punished. Over time, institutions and governments have become increasingly involved in making laws to prohibit market abuse. The general opinion of these institutions resonates in theories that suggest, where two parties in the market bear a condition that allows one to profit from manipulative and illegal conducts causing others to lose is unfair, illegitimate and unacceptable. Yet, there is also the isolated argument of 'victimless crime', meaning that not all forms of market abuse have a direct victim. This argument does not appeal to most many scholars and commentators who hold strongly to the notion that, any act of manipulating the market to make unlawful gains also results in direct or indirect loss to some other regular market participants, and therefore it is wrong and impermissible.

One of the significant challenges, and one that would always exist is the difficulty of predicting or identifying every case of market abuse. There is in fact no law or definite

regulatory framework that can effectively deter professionals and insiders from somewhat using certain privileged information to make gains.<sup>368</sup> Hence, the level playing field argument has become common in justifying a number of economic regulations, including prohibitions on market abuse.<sup>369</sup> Institutions have continued to emerge to interfere in the markets through rules to prevent one party trading in a market through manipulative and fraudulent ways or using information not available to the other leading to an imperfect market. These institutions often act as watchdogs, enforcers and also as warranties of quality or value in situations where asymmetric information might potentially be present.

---

<sup>368</sup> Karmel, R. S. (1998). Outsider Trading on Confidential Information-A Breach in Search of a Duty. *Cardozo L. Rev.*, 20, 83.

<sup>369</sup> McGee, R. W. (2008). Applying Ethics to Insider Trading. *Journal of Business Ethics*, 77, 205-217.

## **Chapter five**

### **Legal framework for financial market regulation, Saudi Arabia and the United Kingdom**

#### **5.1 Introduction**

To achieve a strong, transparent financial market that also attracts the confidence of investors and protects against abuse, regimes have continued to draft new legislation or review existing ones. Modern markets that are becoming saturated with all kinds of product and services which require even more regulation. But not all markets are the same; they differ both in size and the kinds of products they offer. In the UK, the system is that which regulates one of the largest financial markets in the world. Hence, it involves different bodies and an enormous amount of legislation on different kinds of products. Moreover, it is a financial market that has traded in stocks for centuries. Therefore, it has laws that may sometimes differ from those in emerging markets such as Saudi Arabia.

Despite differences in some aspects, both the Saudi and UK laws on financial market have similarities in terms of their approach to issues relating to market manipulation and insider trading. They both have strict legislation on these behaviours, which are considered by both regimes as market abuse. But the way they are dealt with can differ. This chapter intends to look at how financial regulations were built in both jurisdictions by reflecting at the transition of legal framework that led to what is now applicable in both jurisdictions. The chapter will also attempt to focus on areas that deal with issues relating to market abuse. It would also attempt to determine areas of convergence and the areas of differences between the laws.

#### **5.2 Structuring of the Saudi Arabian financial market**

Saudi Arabia's capital market traces its roots back to the mid-1930s.<sup>370</sup> However for most of its formative era, many scholars and observers opined that the financial market

---

<sup>370</sup> Alshogeathri, M. A. M. (2011). Macroeconomic determinants of the stock market movements: empirical evidence from the Saudi Stock market (Doctoral dissertation, Kansas State University).

is mostly unorganised and very informal in nature.<sup>371</sup> At that stage of inception, the members of the monarchy largely dominated the financial system of the Kingdom. Their total monopoly over economic policy and all aspects of governance along with the huge amount of oil revenue continued to dominate the economic system of the Kingdom giving no incentive to consider diversification.<sup>372</sup> Principally, since the Saudi capital market came into place around the 1930s, the main source of revenue had continued to be the export of oil and therefore, very little attention was given to other sectors that are capable of bringing revenue to the country. Research by Aljazira group shows how Saudi originally did not consider the financial industry as a viable alternative mode of capital,<sup>373</sup> to Shari'ah finances.

The turning point was the in the beginning of the 1980s 'Oil Glut', which was as a result of slowing economic activity in industrialised nations that reduced the demand for oil and affected prices. This prompted the debate on the need to diversify the economy.<sup>374</sup> In the quest to achieve this, the rulers of Saudi resorted first to specialised credit institutions such as Saudi Industrial Development Bank (SIDB). Although this was an approach different from the prior reliance on an oil boom, it still became clear that there is the need to develop beyond just credit from a single institution.

The renaissance of what was termed as the fifth development plan started gathering momentum in 1984 and the Saudi industrial market saw the beginning of a new era of reform and change.<sup>375</sup> The emphasis was to create an economy that was based on industry and not only reliant on oil. This saw the first attempt to have the private sector as part of the economic drive.<sup>376</sup> But this also came with the challenge of putting significant capitalisation if the goal of industrialisation set was to be achieved. The first point of access to finance was the SIDB, but that alone proved insufficient.

---

<sup>371</sup> Ibid.

<sup>372</sup> Fasano, U., and Iqbal, Z. (2003). GCC countries: from oil dependence to diversification. *International Monetary Fund*.

<sup>373</sup> The Financing Role of the Saudi Capital Market Promising Prospects. Aljazira group Research Department Economic Reports (2010)

<sup>374</sup> Burbidge, J., and Harrison, A. (1984). Testing for the effects of oil-price rises using vector autoregressions. *International Economic Review*, 459-484.

<sup>375</sup> Al-Sedairy, S. T. (1994). Management of conflict: Public-sector construction in Saudi Arabia. *International Journal of Project Management*, 12(3), 143-151.

<sup>376</sup> Luciani, G. (2005). From private sector to national bourgeoisie: Saudi Arabian business. *Saudi Arabia in the Balance: Political Economy, Society, Foreign Affairs*, 144-181.

This challenge, according to research Aljazira group, highlighted the need for effective utilisation of domestic savings to be adequately mobilised through capital markets, that later prompted the creation of a Committee to pave a new ground that would enable trading in the stock market.<sup>377</sup> The concept however did not do much to develop the industry, neither were finances or infrastructure developed.<sup>378</sup> Hence, there was a record of very slow performance that continued from 1984 until 1997 when the Kingdom formally began allowing foreign investment in its domestic stocks. With an estimated worth of \$530 billion in 2015, it is now among the largest markets in the middle east and by opening its stocks to foreign companies, international firms have been able, from June 2015 to buy stocks in the country's exchange i.e., the Tadawul All Share Index.<sup>379</sup> This is seen as a new opening that allows for direct investment for mutual funds and Exchange Traded Funds (ETFs) to add some Saudi stocks to their holdings, especially in emerging market funds. These ETFs which could be described as equity swap is essentially a marketable security that tracks an index, a commodity, bonds, or a basket of assets. Despite the opening for foreign investors however, the Saudi market is still at a formative stage compared to other advanced financial markets such as the UK.<sup>380</sup>

The active market liberalisation phase that began in 2003 has tremendously benefited the capital market by ensuring high volume of market capitalisation and value of traded commodities. Scholars see the issuance of Royal Decree number M/3 of July 2003 as a turning point in the capital market, bringing in new constitutive law of the securities industry, and particularly the CML.<sup>381</sup> This body of rules came in at a time when the need for diversification is at its peak.<sup>382</sup> What became obvious to most investors is that the new laws will regulate, and standardise issues pertinent to the development of the

---

<sup>377</sup> The Financing Role of the Saudi Capital Market Promising Prospects. *Aljazira group Research Department Economic Reports* (2010).

<sup>378</sup> Al-Suhaibani, M., and Kryzanowski, L. (2000). An exploratory analysis of the order book, and order flow and execution on the Saudi stock market. *Journal of Banking and Finance*, 24(8), 1323-1357.

<sup>379</sup> See, <http://money.cnn.com/2015/04/16/investing/saudi-arabia-stock-exchange-opens-to-foreigners-june-15/>

<sup>380</sup> Elfakhani, S., Hassan, M. K., and Sidani, Y. (2005, December). Comparative performance of Islamic versus secular mutual funds. In 12th Economic Research Forum Conference in Cairo, Egypt (pp. 19-21).

<sup>381</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The Ann. Surv. International and Comp. L.*, 18, 115.

<sup>382</sup> Ibid.

capital market.<sup>383</sup> The new legislations cover issues relating to registration, listing and operation of stocks, securities and public offers.<sup>384</sup>

Research however shows that The Saudi capital market is still among the least open markets in the Gulf Co-operation Council (GCC) and among those with limited foreign participation. One of the earliest efforts made to boost the market for foreign investment came via The Saudi Arabian Capital Market Regulation, Royal Decree No. M/30 of 2nd Jumada Thani 1424 Hijra (31st July 2003). The Decree opens the way for foreigners to buy shares listed in the Saudi market through what is called a swap agreement.<sup>385</sup> But even as at 2008, a research by Aljazira suggest that the value of trade by foreign investors only stands at 3.8 percent compared to other GCC countries that have foreign investment reaching up to 40 percent.<sup>386</sup>

This chapter focuses on the Saudi authority quest to develop and diversified its financial system and securities laws. In particular, it explains the role of the regulating authorities' i.e. the CMA and the structure as well as the nature and their functions as laid down by the statutes and legislations i.e. the CML, which governs the entire conduct and activities of all capital market participants in the Kingdom.

### 5.2.1 The Capital Market Law (CML)

The year 2003 was a good year for the International stock markets and that was the year Saudi saw the opportunity to enact a Decree that would usher in a new era in its own financial industry. The King then issued a far-reaching Royal Decree number M/3 that saw the establishment of the CML.<sup>387</sup> As Gouda argues, the idea of consumer protection is not new to the Saudi Kingdom, but the enactment of a comprehensive law

---

<sup>383</sup> Ibid.

<sup>384</sup> Alshowaiman, N. S. (2013). The Internet Financial Reporting by Listed Saudi Companies on Tadawul Website:(Between 2004 and 2005). *Journal of Administrative and Economics Science*, 6(2).

<sup>385</sup> The Saudi Arabian Capital Market Regulation, Royal Decree No. M/30 of 2nd Jumada Thani 1424 Hijra corresponding to 31st July 2003 Gregorian, sets out the framework for the capital market including the establishment of the Saudi Arabian securities and exchange commission, known as the Capital Market Authority (CMA), with objectives of protecting investor interests, ensuring orderly and equitable dealings in securities business, and promotion and development of the capital market. See also Salinas, F. (2008). Harmonisation Is the Key to Success. *International Fin. L. Rev.*, 27, 50.

<sup>386</sup> The Financing Role of the Saudi Capital Market Promising Prospects. *Aljazira group Research Department Economic Reports* (2010)

<sup>387</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003. *The. Ann. Surv. International and Comp. L.*, 18, 115

to regulate many aspects of the financial market is a big stride in the bid for a more coherent regulatory framework that protects investments among capital market participants.<sup>388</sup> The aim of this was to redefine and standardise securities regulation and consumer protection in an emerging market.<sup>389</sup> Principally, the CML is mainly a statute that guarantees consumer protection. This however is an upward development from other previous laws such as the Saudi Law against Deception in Trade of 1984,<sup>390</sup> and the advertisement regulations law of 1992.<sup>391</sup> Other laws enacted to consolidate the CML include the 2004 Competition Law of 2004.<sup>392</sup> Other laws and regulations include, Anti-Money Laundering and Counter-Terrorist Financing Rules,<sup>393</sup> Merger and Acquisition Regulations,<sup>394</sup> Real Estate Investment Funds Regulations,<sup>395</sup> Corporate Governance Regulations,<sup>396</sup> Investment Funds Regulations, Offers of Securities Regulations,<sup>397</sup> Listing Rules,<sup>398</sup> Securities Business Regulations,<sup>399</sup> Authorized Persons Regulations,<sup>400</sup> and Market Conduct Regulations.<sup>401</sup> These are also called implementing rules because, in their entirety, they are structured as a framework or a mechanism for the enforcement and the implementation of the constitutive law, the Capital Market Law.

Although securities are among the main aspects covered by the CML, it is important to state that the statute did not give a comprehensive definition of securities.<sup>402</sup> Instead, it gives a broader and multifactorial description of securities by identifying them alongside certain schemes and transactions. The Law specifically says the term “Securities” shall mean:

---

<sup>388</sup> Ibid.

<sup>389</sup> Ramady, M. A. (2010). The Saudi Capital Market. In *The Saudi Arabian Economy* (pp. 145-177). Springer US.

<sup>390</sup> Law against Deception in Trade, Royal Decree No. M/11, 29/05/1404H (Jan. 3, 1984)

<sup>391</sup> Rules Regulating Advertisements, Royal Decree No. M/35, 28/12/1412H (June 28, 1992)

<sup>392</sup> Competition Law, Royal Decree No. M/25, 4/5/1425H (June 22, 2004)

<sup>393</sup> Board of the Capital Market Authority Resolution No. 1-39-2008, 3/12/1429H (Jan. 12, 2008)

<sup>394</sup> No. 1-50-2007, 21/9/1428H (Mar. 10, 2007)

<sup>395</sup> No. 1-193-2006, 19/6/1427H (July 15, 2006)

<sup>396</sup> No. 1-212-2006, 21/10/1427AH (Dec. 11, 2006)

<sup>397</sup> No. 2-11-2004, 20/8/1425H (April 10, 2004)

<sup>398</sup> CMA Board Resolution, No. 2-128-2006, (Jan. 22, 2006)

<sup>399</sup> No. 2-83-2005, 21/05/1426H (June 28, 2005)

<sup>400</sup> No. 1-83-2005, 21/05/1426H (June 28, 2005).

<sup>401</sup> No. 1-11-2004, 20/8/1425H (April 10, 2004).

<sup>402</sup> Beach, J. W. (2005). Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets, *The. Stan. J. International L.*, 41, 307; See also Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The. Ann. Surv. International and Comp. L.*, 18, 115



- a. Convertible and tradeable shares of companies;
- b. Tradeable debt instruments issued by companies, the government, public institutions or public organisations;
- c. Investment units issued by investment funds;
- d. Any instruments representing profit participation rights, any rights in the distribution of assets; or either or the foregoing;
- e. Any other rights or instruments which the Board determines should be included or treated as Securities if the Board believes that this would further the safety of the market or the protection of investors. The Board can exercise its power to exempt from the definition of Securities rights or instruments that otherwise would be treated as Securities under paragraphs (a, b, c, d) of this Article if it believes that it is not necessary to treat them as Securities, based on the requirements of the safety of the market and the protection of investors

Referring to this provision, Gouda pointed out that it is technically a broad explanation of what securities connote, which may “not mean a lot for a person sitting on a bench because actually there is no disagreement on all the types of securities listed in these subsections. Rather, the disagreement is on what has not been mentioned.”<sup>403</sup> Similarly, looking at the definition as compared to the UK, especially what is found the RAO,<sup>404</sup> Saudi legislations made no specific reference to aspects such as derivative contracts, futures, options and contracts for differences. The CML provides a short definition of securities and give broader discretion to the CMA and the CRSD to either “define the term security, and to exclude from, or include in the definition what it sees fit.”<sup>405</sup>

The challenge to this according to Gouda is that there is no standard or well-defined test as to what may constitute a security. The only implied point of reference is Article 2(e), which states: “based on the requirements of the safety of the market and the protection of investors the Board has the power to include or exclude from the

---

<sup>403</sup> *ibid*

<sup>404</sup> Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544). This has been amended and extended on numerous occasions since it was originally introduced to adapt to the extended remit of the FSA/FCA in accordance with the political will of the UK government

<sup>405</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The Ann. Surv. International and Comp. L.*, 18, 115

definition what it believes to be or not to be a security.”<sup>406</sup> This is a clear distinction from the UK regime.

The statute also failed to “point to any type of test the judge should deploy to make the call. However, if we considered the test for determining whether an instrument is a security as safety of the market.”<sup>407</sup> This indeed is a challenge to the Saudi market and especially to investors who take interest on every aspect of the regulatory framework. Moreover, the fact that the law explicitly gives the authorities i.e. CMA the discretion to define, in their own terms what should or should not be regarded as security also opens up the challenge on the need for caution and transparency on how such discretion is used in the market and how it affects companies.<sup>408</sup>

As the main regulatory legislation for capital market activities, the CML provides for both private and public offering.<sup>409</sup> This however came after the 2008 amendment to the rules regulating offers of securities in the Saudi capital market.<sup>410</sup> The pre 2008 regulation was one that restricts the issuance of securities in the Saudi market to only joint companies. The provision, which allowed for these new types of offer of both private and public securities, is contained in the new amendment. Under this amendment in the CML, a private offering, termed ‘private placement’ is made either to some specified group of persons or to the government.<sup>411</sup> Public offering on the other hand is one that entails offers to the public at large, where the CMA supervises every aspect.

### **5.2.2 General framework of the CML**

Although the CML is the framework that is meant to regulate the entire securities market in Saudi, it is primarily conceptualised to deal with public offering of securities. The CML is seen by many scholars as the pioneer initiative of the Saudi authorities to

---

<sup>406</sup> Capital Market Law, Article 2(e)

<sup>407</sup> 15 U.S.C. Section 77b (a) (10) (2006).

<sup>408</sup> Issa, N., and Stull, J. (2014). Saudi Arabia: Steady Growth amidst New Regulations. *The Islamic Finance Handbook: A Practitioner's Guide to the Global Markets*, 421-432.

<sup>409</sup> Beach, J. W. (2005). Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets, *The Stan. J. International L.*, 41, 307.

<sup>410</sup> CMA Board Resolution, No. 1-28-2008

<sup>411</sup> Article 6-7, Offers of Securities Regulation.

design a standardised capital market regulation in line with international practices.<sup>412</sup> This legislation or regulation contains details on market safety for investors, rules compelling disclosure, prospectus and those against market manipulation and insider trading.<sup>413</sup> For example, before making any public offer, the CML requires disclosure by companies to ensure optimum transparency in the market and ensure that individual or organisations wanting to invest have accurate information about the nature of the securities and other relevant information necessary for making informed decisions.<sup>414</sup> Another safeguard to investors is the requirement by the CML that all companies listed in the Saudi stock market submit periodical updates to the Capital Market Authority on the state of their finances and managerial situations or changes.<sup>415</sup> This helps the Authority to figure out and reject any public offering that does not qualify under the provisions of the CML. The intent of this provision is to give all investors the assurance that only good securities would be allowed into the public market.<sup>416</sup>

Secondly, the periodic checks ensure that those who have already subscribed to active or listed securities are protected as well and assured of the safety of their investment.<sup>417</sup> Gouda argues that all these measures put in place through the CML were meant to serve some important market values. One of the foremost reasons is to do with investor confidence. In the sense that, those who intend to subscribe to newly offered securities would have the assurance of making the right decisions and the confidence that the Market Authorities will safeguard their interest and investment against any unscrupulous market behaviour. Moreover, this gives them the chance to make an informed decision and in the meantime, makes them feel that the Authority is there for them and is guarding them against any unscrupulous business offers. This relates to the issues of information asymmetry that was discussed in previous chapters, particularly in chapter four.

---

<sup>412</sup> Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87.

<sup>413</sup> *ibid*

<sup>414</sup> Hassan, O. A., Giorgioni, G., and Romilly, P. (2006). The extent of financial disclosure and its determinants in an emerging capital market: the case of Egypt. *International Journal of Accounting, Auditing and Performance Evaluation*, 3(1), 41-67.

<sup>415</sup> *ibid*

<sup>416</sup> Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87.

<sup>417</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The Ann. Surv. International and Comp. L.*, 18, 115

It is important however to state that an ‘offer’ as defined under the CML is distinct from the common idea of offer found in contract law. The definition given under the CML encompasses not just the “expression or statement to be bound if accepted by the offeree, it is rather broader than that. It is broad because traditional offers are governed by time and they must be specific.”<sup>418</sup> This essentially indicates, “the offeree must decline or accept the offer and what has been offered while the parties are still in the *muglis al-akad*.”<sup>419</sup> Specifically, Article 1 of the CML defines offer to mean the issuing of securities; inviting the public to subscribe therefore or the direct or indirect marketing thereof; or any statement, announcement or communication that has the effect of selling, issuing or offering securities. The provision however did not include preliminary negotiations or contracts entered into with or among underwriters.<sup>420</sup>

### **5.2.3 Regulations under the CML**

While the CML provides the law that regulates every aspect of the Saudi financial market, it has provided strict provision against market abuse. The law has also made significant progress in establishing its supervision credentials. As a law that guarantees Saudi being a party to the International Organization of Securities Commissions (IOSCO), it has also enhanced the areas of information sharing with other regulators around the world.

#### **(a) Regulation on market abuse**

The CML defines any intentional act by an agent with a view to create a false or misleading impression as to the market, the prices or the value of any security is an abuse of the market.<sup>421</sup> Article 49 of the law states further that any act that creates misleading impression over prices or the value of any security thereby inducing third parties to buy, sell, or subscribe for such security or to refrain from doing so is deemed an act of market manipulation. Manipulation of the price of a security is a frequent phenomenon in the Saudi market where transactions in securities do not always involve

---

<sup>418</sup> Ibid.

<sup>419</sup> Ibid.

<sup>420</sup> Article 1, Offers of Securities Regulations of Saudi Arabia.

<sup>421</sup> CMA (2011). Manipulation and insider trading.

the true transfer of ownership.<sup>422</sup> This according to Baamir occurs mainly because the CMA is not always proactive in its disciplinary actions against violators. He further gave instances of how this occurs which includes practices where an investor sells securities from one fund and at the same time, buys an equivalent amount from another fund that was managed by him or her, giving the impression that there is an active trade on that particular share and increase in the price of that particular security.<sup>423</sup> Similar situations can be traced to for example the case of *Georgiakis*<sup>424</sup> who engaged in what is commonly termed as ‘painting the tape’, which involves an artificial way of augmenting trading volume that will today be regarded as market manipulation under MAD 2.<sup>425</sup>

Insider information on the other hand was defined under Article 50 of the CML in a way that is somewhat similar to the provisions of the Financial Services and Markets Act (FSMA) 2000. Essentially, the general idea about insider information under both Saudi and UK laws is that they refer to any information obtained by the insider and which is not available to the general public, has not been disclosed.<sup>426</sup> The idea behind prohibition is because of the extent of effect such information have on other market participants, as its release and availability could have a material effect on the price or value of a Security related to such information. This is while the insider is aware that such information is not generally available and that, if it were available, it would have a material effect on the price or value of such security.<sup>427</sup> Insiders often benefit from this at the expense of other, which also affects the credibility and transparency needed for a market to be fair to all participants.

Like other regulatory frameworks in other jurisdictions, the CML was largely meant to create a safe investment environment and ensure adherence to the standards of

---

<sup>422</sup> Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87.

<sup>423</sup> Ibid, p 76.

<sup>424</sup> C-391/04. *Ipourgos Ikonomikon Proistamenos DOI Amfissas v Charilaos Georgakis*

<sup>425</sup> MAD II is successor to MAD. Due to the increasingly global nature of financial markets and the development of new trading platforms and other issues such as the manipulation of certain benchmarks such as LIBOR it became essential that MAD be reviewed, hence the development of MAD II. In 2014 the Market Abuse Regulation (MAR) and the Directive on Criminal Sanctions for Market Abuse (CSMAD and, together with MAR, MAD II) were published in the Official Journal. They each have an implementation date of 3 July 2016. See also Bainbridge, S. M. (Ed.). (2013). *Research handbook on insider trading*. Edward Elgar Publishing.

<sup>426</sup> Part V, CJA 1993. Also CMA (2011). Manipulation and insider trading.

<sup>427</sup> Article 50 of the CML.

transparency and legality.<sup>428</sup> To achieve this, the CML mandates all financial institutions to disclose information to their investors and the public on their activities. It also requires the companies to make public the managerial personnel of the company i.e. those individuals that are in charge of the activities of the company as well as the major shareholders of the company.<sup>429</sup> This in essence is to protect the investor and make clear to the investor and the public what the company stands for in terms of strength, so that parties wishing to participate in the company would do so based on information that is readily available.<sup>430</sup> The prospectus must also disclose and describe clearly "the securities to be issued, as well as privileges, rights, and preferences of the issuer's other securities, if any, as well as the issuer's financial position." Specifically, Parts 4, 5, and 6 of the Saudi Listing Rules mandates companies to make disclosure of all the information necessary for a transparent market activity.<sup>431</sup> For example, Article 12a of the Listing Rules of the SSE provides that the prospectus of a company must at all times contain every necessary information that is required for an investor to assess the strength of the company. This includes information on "assets and liabilities, financial position, management, and prospects of the issuer and of its profits and losses... as well as information covering aspects such as "the obligations, rights, powers, and privileges attached to the relevant securities as well as an overview of the risk factors and the future of the issuer and its business."<sup>432</sup>

The case of a misleading or false content in the prospectus, senior officers, underwriters and issuers bear the liability.<sup>433</sup> The manner in which this action begins is via a complaint by the alleged victim, which shall be investigated by the authority, and a case would be opened against the company before the CRSD. The CML further provides that, where such complaint is filed with the Authorities, the investor who filed such complaint has to wait for ninety days for the bureaucratic procedure to be concluded, after which the complainant is informed that he can file his case to the CRSD.<sup>434</sup> When

---

<sup>428</sup> Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87.

<sup>429</sup> *ibid*

<sup>430</sup> Alanazi, B. M. G. A. (2012). Investor protection and the civil liability for defective disclosures in the Saudi securities market: *a legal analysis*.

<sup>431</sup> Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87.

<sup>432</sup> Article 12 of the SSE Listing Rules.

<sup>433</sup> Article 55(b) CML

<sup>434</sup> Article 25-26 CML

a case is before the CRSD, evidence can be obtained without warrant.<sup>435</sup> Hence, this affects the civil rights granted to criminal suspects under Section 3-4 of the Criminal Procedure law of 24/08/1422H.<sup>436</sup> Therefore, in a way, this provision of the CML is seen to violate some fundamental aspects of the justice system. Yet, proponents are of the view that the procedure is effective in ensuring expeditious and successful prosecution that in the last decade, this process have continued to apply in cases before the CRSD. Importantly, this brings the challenge of the overlap of regulatory and criminal inquiries. The EU case of *Grande Stevens*<sup>437</sup> for instance raised these question, specifically concerning the nature of administrative sanctions and issues of due process and even double jeopardy in cases of insider trading and market manipulation.<sup>438</sup>

To further guard investors, the CML clearly states that where the company gives out wrong or misleading information about its products or activities, the unsuspecting investor has the right to claim damages against the company by seeking a remedy through the CML established CRSD. Principally, the case of a misleading statement can be brought forward as a complaint by the victim, which will then become a subject of investigation by the authority and a case may be opened against the company before the CRSD. The CML further provides that, where such complaint is filed to the Authorities, the investor who filed such complaint has to wait for ninety days for the bureaucratic procedure to be concluded, after which the complainant is informed that he can file his case to the CRSD.<sup>439</sup>

The CMA also engage itself in scrutinising the prospectus to ascertain whether it is accurate or not. The only responsibility it discharges is to simply review the completeness of the prospectus. However, Article 55(a) states that where the company omits any important information from the prospectus and that results in loss or damage to the investor, then as such the investor reserves the right to seek for damages Under

---

<sup>435</sup> *ibid*

<sup>436</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003. *The Ann. Surv. International and Comp. L.*, 18, 115.

<sup>437</sup> *Grande Stevens v Italy* (App No.18640/10, 18647/10, 18663/10,18668/10) (2014) ECHR 4 March 2014.

<sup>438</sup> Ventrizzo, M. (2014). Do Market Abuse Rules Violate Human Rights? The *Grande Stevens v. Italy* Case. *The Grande Stevens v. Italy Case (October 2014). European Corporate Governance Institute (ECGI)-Law Working Paper*, (269).

<sup>439</sup> Article 25-26 CML

Article 55(a). The investor however is cannot bring similar damages against the CMA.<sup>440</sup>

Like most laws in arbitration and civil justice, the CML has also provided a period of limitation on suits by investors against companies. In particular, the law deals with issues arising from the violation of CML sanctioned disclosure of information and other issues covered under the CML,<sup>441</sup> i.e., unfair or manipulative practices. According to the CML, the period within which a case should be filed is 5 years.<sup>442</sup> For actions arising from violations of regulations, action must be brought within one year in which the claimant is expected to be aware of the damage or loss.<sup>443</sup> The CML does not provide for an extension of time beyond five years in which to bring an action. Some scholars however point out that the absence of an extension beyond five years could be a problem in some circumstances.<sup>444</sup> Providing a lengthier period according to Gouda is significant to alleviate certain occurrences that are peculiar to the capital market.<sup>445</sup> Explaining this paradox, he states, if the investor/victim does not discover the crime within the five year period, then his or her right to file a suit is forever forfeited. Again it is important to note the legitimacy of Gouda's argument in the sense that this kind of situation could happen where the crime is designed in a way that the victim may not discover it at an early stage.<sup>446</sup> Yet, limitation periods are not only peculiar to Saudi, they also exist in Western jurisdictions but in a different way. This also raises a point of comparison with the laws in the In England under the Limitation Act 2000 which provides for six years and also the Prescription and Limitation (Scotland) Act 1973 which gives a limitation of five years. Both laws provide that the periods run from the moment the crime was discovered.

He further gave examples with securities that mature after more than five years. In the event of such investment, it is unlikely for the investor to discover any fault within the

---

<sup>440</sup> Soliman, M. (2013). Ownership Concentration and Firm Financial Performance-Evidence from Saudi Arabia. SSRN 2257832.

<sup>441</sup> Article 49-50 CML.

<sup>442</sup> Article 58 CML

<sup>443</sup> Articles 55-57 CML

<sup>444</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003. *The Ann. Surv. International and Comp. L.*, 18, 115.

<sup>445</sup> Ibid.

<sup>446</sup> Ibid.



stipulated 5 years. Moreover, he pointed out to the familiar situations where financial administrators cook their books and it becomes hard for an ordinary investor to realise the ill done until after years of the incident.<sup>447</sup> What is shown here is that, the limitation period contained in the CML exposes some investors to unwarranted risk. Principally, since some securities take long to mature, and looking at other instances in financial markets around the world where certain irregularities only come to the knowledge of investors or regulators years after they have been perpetrated, it is important to review this law regarding limitation as to when an investor can bring an action against any act that defraud or manipulated the market. Moreover, it is logical to argue that, irrespective of how old a crime is, the question of statute of limitation should be based on many factors including the legitimacy that the investor is naturally unlikely to know of the incident at the most appropriate time. For example, in March 2015 Carney, the Governor of the Bank of England stated that the Bank of England missed as many as 50 instances of suspected market abuse.<sup>448</sup> Even though it is not the duty of the bank to trace cases of market abuse, this statement sends a significant message about cases of abuse that are not always readily discoverable, some may be discovered within a short time, others can go on for a longer period of time before they are discovered. Hence, the limitation period on market abuse cases may sometimes prove problematic, especially when there is a clear case of market abuse but victims are barred by law to bring an action due to lapse of time.

The prohibition of market manipulation and insider trading set out in the CML essentially corresponds to most common international standards of financial market ethics and regulations such as the IOSCO<sup>449</sup> Manual on Investigating and Prosecuting Market Manipulation 2000. International Organization of Securities Commissions (IOSCO).

IOSCO. This according to Baamir has contributed tremendously in creating a new phase based on global standards within the Saudi market and reduced the potential for

---

<sup>447</sup> Ibid.

<sup>448</sup> See, <http://www.thetimes.co.uk/tto/business/industries/banking/article4370849.ece>. Accessed on 10th October 2015.

<sup>449</sup> International Organization of Securities Commissions (IOSCO), is regarded as the global standard setter for securities.

market abuse and manipulation.<sup>450</sup> It is important to state that, one of the aspects that the CML takes seriously in its provisions is the issue of market manipulation and the sanctions for it. This concern was out of the fear that without investor confidence, the aspiration for a new market in the Arab world may not be actualised. Any situation that is capable of making the market vulnerable to manipulative activities must be checked and avoided.<sup>451</sup>

The CML for instance deals with the subject of market manipulation in its definition of the offence, stating that it is a violation to act or engage in any act which creates a false or misleading impression as to the market; the prices or the value of any security for the purpose of creating that impression; or thereby inducing third parties to buy, sell, or subscribe for such security or to refrain from doing so; or to induce them to exercise, or refrain from exercising, any rights conferred by such security.

The need for improved regulatory framework against market abuse became of utmost importance because of the growing need to diversify the market and make it safe and attractive. It is also significant to check the growing unethical behaviour of market participants who sell securities from one fund and buying the same amount from another that was managed by them at the same moment.<sup>452</sup> This manipulative strategy once became common among participants, and they used it to give the public the impression that the company is active in trading and the shares been dubiously exchanged and converted are valuable. Aside earlier reasons discussed, this practice becomes possible because of factors such as the “absence of Market Makers in the Saudi Stock Exchange (SSE) and by the lack of knowledge and experience by the majority of small investors.”<sup>453</sup>

Taher also showed the effect of this was the way it allowed the market to be proliferated with speculators.<sup>454</sup> For example, findings show that shares prices of 70

---

<sup>450</sup> Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87.

<sup>451</sup> Ibid.

<sup>452</sup> Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87

<sup>453</sup> ibid

<sup>454</sup> Taher, N. (2004), A Clearer Path For Investors. *Banker*, 12, as cited in Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87

companies out of 81 listed companies traded in the market were overvalued.<sup>455</sup> Such practices often harm the ability to raise local funds in the future as small investors who lost their investment might not be able to subscribe widely in further IPOs, and such practices have already created some sorts of social crises within the society, especially for small speculators.<sup>456</sup> Again, even if these small investors have the funds, they may be unwilling to commit further to the market because of the perception that the market is not safe.

The regulation under the CML also requires the prospectus of a company to contain a sufficient summary of the bylaws, financial information about the issuer, its group as well as its management.<sup>457</sup> Added to this is the requirement to include comprehensive information relating to all new issues, voting rights, dividends, “rights of redemption or repurchase, or the right to surplus assets on liquidation, winding up or otherwise, all other significant information regarding the rights of a shareholder.”<sup>458</sup>

Moreover, the provisions of the CML has gone further to grant the CMA the powers to request a company to add other information to its prospectus or to demand the company to shoulder additional obligations, especially in industries that involve mining and insurance.<sup>459</sup> This additional and sometimes continuing obligations are imposed in circumstances where it becomes clear that the company needs to take such steps if the original objectives of information disclosure is to be achieved. Especially where such obligation is necessary to maintain an orderly market and also protect the rights of participants. For example, Part 6 of the SSE Listing Rules clearly provided for these and Article 25 goes further to indicate how these kinds of responsibilities arise.<sup>460</sup> The legal requirement is companies to notify the public and authorities of any major changes. The provision in the SSE listing rule also states that where in the opinion of any issuer, disclosure of any matter required by these Rules would be unduly

---

<sup>455</sup> Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87

<sup>456</sup> Taher, N. (2004), A Clearer Path For Investors. *Banker*, 12, as cited in Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87

<sup>457</sup> Annex 4, SSE Listing Rules.

<sup>458</sup> Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87

<sup>459</sup> Article 17 of the CMA Listing Rules; See also, Al Kahtani, F. S. (2013). The Saudi External Institutional Framework for Corporate Governance.

<sup>460</sup> Ibid.

detrimental to the issuer, the issuer may apply for a waiver. However such waiver is subject to the condition that the omission of such information is not likely to mislead investors on the essential knowledge needed to assess the securities.<sup>461</sup> Although the provision of the SSE did not give comprehensive and specific details on the grounds upon which such waiver would be justifiable, its counterpart the CML has provided such detail showing specifically that such exemption do not include business sensitivity or an exemption on the entire contract.<sup>462</sup> This perhaps shows that the CML is designed to minimise the granting of exceptions to this general rule and is specific on the details. This could be attributed largely to the size of the market as the Saudi market is not one that expects different complex circumstances, it is easier to have a clear position on exceptions.

#### **(b). Regulations on Initial and continuous Disclosure**

The idea of disclosure of relevant information to the public is an important principle under the CML. All companies engaged in the capital market must abide by this and other regulations as stipulated in the regulations. As Gouda pointed out, making available to investors sufficient information on offering company's financial status, its affiliates, directors, securities issued, and shareholders cannot be avoided by any of the companies.<sup>463</sup> Moreover, giving reliable information is a responsibility the company must adhere to because any damage or court action for misleading information can be successfully brought against the company

As stated earlier, the document to be filed for disclosure and listing which must contain all relevant information is the 'prospectus', which is the communication, written or by radio or television or the internet, which offers any security for sale or confirms the sale of any security.<sup>464</sup> Once it is prepared, the law requires that it should be distributed among potential investors and be made available online via the CMA's website.<sup>465</sup>

---

<sup>461</sup> Article 18 of the SSE Listing Rules.

<sup>462</sup> Article 18 of the SSE Listing Rules.

<sup>463</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The Ann. Surv. International and Comp. L.*, 18, 115

<sup>464</sup> The CML did not explicitly define what a prospectus is, but the wording of Article 40(c) is generally construed as the meaning of prospectus

<sup>465</sup> Alshowaiman, N. S. (2013). The Internet Financial Reporting by Listed Saudi Companies on Tadawul Website:(Between 2004 and 2005). *Journal of Administrative and Economics Science*, 6(2).

While a substantive definition of a prospectus was not given by the CML, a portion of the Glossary of Terms defines it as the document required by companies when making offers of securities in accordance with the Capital Market Law.

Fundamentally, no public offer can be made unless a prospectus had been duly filed with the CMA and all the requirements have been fulfilled. Once the authorities approve the prospectus, the company then goes ahead to register all its securities with the CMA. This is then followed by a public offer. The announcement or publicity of such an offer must contain at least a summary of the prospectus, as these are necessary information for any investor wishing to invest in the company.<sup>466</sup> Most significantly is that an approval of the prospectus by the CMA is a necessary ingredient for the publication of the prospectus to the public and the offer of securities. Where the CMA, for any reason refuses to approve a prospectus, then the company is not allowed to publish the information or to make an offer to the public of its security.<sup>467</sup>

On the aspect of perpetual disclosure of changes in a company, the CML has made an additional provision for another form of disclosure called the continuous disclosure. Bearing the name, this type of disclosure is mainly about the reports and publicity that a company must make in the event of any important changes or alterations in the administrative, shareholder, financial or product structure of the company.<sup>468</sup> Pursuant to this requirement all listed companies must disclose all relevant information through annual or quarterly submission and disclosure of fiscal statements, changes in capital that might affect the company, changes in the board of directors, senior executives or even change in address etc.<sup>469</sup>

### **(c). Regulation on dispute and violations.**

According to the standards of the CML, investors who suffer damage in their investment can only bring an action before the judicial bodies designated by the

---

<sup>466</sup> Article 40(c) CML.

<sup>467</sup> Article 40-41 CML

<sup>468</sup> Al-Kahtani, F. S. (2014). Current Disclosure and Transparency Practices in Saudi Corporate Governance. *Arab Law Quarterly*, 28(2), 176-192.

<sup>469</sup> Chapter 7 CML

CMA.<sup>470</sup> Essentially, no suit can be instituted before any civil court in the Kingdom. Similarly, disputes on securities between participants cannot be instituted before conventional courts.<sup>471</sup> Moreover, no case tried by the CRSD can be appealed before conventional courts. As Gouda pointed out, this means once the case has reached the Appeal Panel from the CRSD, it has exhausted all the available remedies under the Saudi system. At this point, the case becomes, more or less, akin to a *res judicata* case in the common law system.<sup>472</sup>

#### **(d). Regulation on jurisdictional boundaries**

The CML applies to markets in the Saudi Kingdom; hence the geographical jurisdiction is Saudi Arabia. The provisions of the CML specifically states that the law does not apply to securities or dispute thereof emanating from outside the Saudi territory even if trading in such a market originates within the Kingdom.<sup>473</sup> But the law allows the CML to assume jurisdiction in respect to violations for foreign law that took place in a foreign country. Essentially, what this means is that, where foreign laws are violated by any individual or group and the same individual or group carries out business within the Kingdom, the CMA has a form of penalty which involves the suspension of the licence of such violators for twelve months.<sup>474</sup> But for such suspension to take place, the CMA must be notified of the violation by the foreign regulator as provided by the law.<sup>475</sup> However, the argument by scholars is the inclusion in the provision of the CML that such notification by a foreign regulator must be a ‘formal’ notification. The term ‘formal’ is somewhat subject of debate, as it is not clear whether, for the purpose of the CML, a judgment against a violation of foreign laws constitutes a formal notice. From the face of the statute however, the answer is no. If not, the publication of such a judgment in legal reports or the media may still be a notice, but it does not constitute a

---

<sup>470</sup> Alanazi, B. M. G. A. (2012). Investor protection and the civil liability for defective disclosures in the Saudi securities market: *a legal analysis*.

<sup>471</sup> Al-Shamrani, A. S. (2014). Islamic financial contracting forms in Saudi Arabia: Law and practice (Doctoral dissertation).

<sup>472</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003. *The Ann. Surv. International and Comp. L.*, 18, 115.

<sup>473</sup> Article 20(b) CML

<sup>474</sup> This is contained in Article 62(a)(4) CML; see also, Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003. *The Ann. Surv. International and Comp. L.*, 18, 115.

<sup>475</sup> Article 62(a)(4) CML

notice as specified under the statute.<sup>476</sup> The insistence on formal notice may sometimes defeat the purpose of the statute, which was originally meant to check bad practices and ensure the safety of the markets. Hence, authorities should not be tied to the idea of ‘formal notice’. Instead, they should have the leverage to act on any credible information and should not actually matter where it is coming from in as much as it is relevant and credible.

This notwithstanding, what the law clearly states is that in certain circumstances, violations outside the borders of the Kingdom can still be treated and sanctioned by invoking provisions of the CML. Most importantly is that, with the growing demand for fair market practices, regulators around the world share information on potential bad practices and violations.

#### **(e). Regulation on exclusion of instrument**

Primarily, the CML did not clearly define what constitutes a security; hence, the questions of discretion by the CMA and those of jurisprudence come into play. Yet, Article 3 of the CML clearly specified some instruments that are not subject to securities regulation. The instruments include order notes, bills of exchange, insurance policies, checks, documentary credit and commercial instruments that are exclusive traded among banks.<sup>477</sup> Although insurance policies are regarded under the CML as not part of securities, this does not include insurance company stock and other products such as insurance bonds that are sold in the market. Therefore the exemption is mainly is an exemption in transaction not an exemption in securities that are readily sold in the market.<sup>478</sup> Perhaps, some may argue that this does not cover all instruments. But Gouda argues that some of these instruments were excluded because these instruments are often given as securities for short-term maturity transactions in which a party pays some kind of consideration for the unconditional promise of the other party to pay.<sup>479</sup>

---

<sup>476</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003. *The Ann. Surv. International and Comp. L.*, 18, 115.

<sup>477</sup> Article 2(e) CML

<sup>478</sup> Seligman, J. (2004). *Fundamentals of securities regulation*. Aspen Publishers Online.

<sup>479</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003. *The Ann. Surv. International and Comp. L.*, 18, 115.

### 5.3 Framework of UK Market laws

In discussing financial markets of regimes such as the UK, especially the development and nature of market laws, one has to admit the size of the market, the enormous amount of products and service and how this often results in constant reviews of laws and regulations. It is also relevant to understand that the UK is directly affected by EU legislations. Being a member of the continental bloc, regulations of the EU automatically form part of UK laws. Directives like the MAD are example of these legislations.

Primarily, the history of stocks related transactions in England dates back to the times around the 15<sup>th</sup> century. Although the early history of stocks in England suggest that there was no government regulation evidence suggest that market participants have, since early times, devised a means to regulate the trade and ensure that fraud and risk and kept at the minimal.<sup>480</sup> A more developed stock exchange was one that was created by 18<sup>th</sup> century brokers London Stock Exchange.<sup>481</sup> This is far different from the history of stocks and other products of the financial market that are relatively new to Saudi market. In particular, the UK has continued to be among the dominant financial centres of the world and still occupies one of the largest capital exchanges.

Centuries after stocks have begun trading in London, and well after the industry has developed to include other kinds of services, the need came for a regulatory regime that would ensure safety and guarantee transparency and good behaviour among market participants. There was recommendation in the 1970's for a law in relation to insider dealing, which was given effect in 1980 and a law was passed in 1985 called Companies Act of 1985 and some amendments that later followed ushered in a reviewed version of the law called the Companies Securities (Insider Dealing) Act 1985.<sup>482</sup> The law was so limited in scope that in 1986 a review came about that gave the government more powers of enforcement.<sup>483</sup> The main article under the Act was to

---

<sup>480</sup> Stringham, E. P. (2002). The emergence of the London stock exchange as a self-policing club. *Journal of Private Enterprise*, 17(2), 1-19.

<sup>481</sup> Ibid.

<sup>482</sup> Riley, C. A. (1992). Contracting out of company law: Section 459 of the Companies Act 1985 and the role of the courts. *The Modern Law Review*, 55(6), 782-802.

<sup>483</sup> Companies Securities (Insider Dealing) Act 1985. See, [http://www.legislation.gov.uk/ukpga/1985/8/pdfs/ukpga\\_19850008\\_en.pdf](http://www.legislation.gov.uk/ukpga/1985/8/pdfs/ukpga_19850008_en.pdf) Accessed on 04/01/2015. See also Alexander, K. (2001). *Insider dealing and market abuse: the Financial services and markets act 2000*. ESRC Centre for Business Research, University of Cambridge.



disallow person with insider information over markets from trading until such information is within public domain.<sup>484</sup> Although not many convictions were obtained under this law, it was still a clear legislation that made insider trading a punishable offence.<sup>485</sup>

Later, the provisions in the 1985 Act were repealed and replaced by the Criminal Justice Act (CJA) 1993, as a way to ensure compliance with Insider dealing directive of the EU. Later developments include the promulgation of FSMA 2000. Taking these transitions of enactments and reviews into context, it is clear that the question of insider trading and acts that are deemed as manipulative of the financial market are not new.

### **5.3.1 The Criminal Justice Act (CJA) 1993**

The CJA 1993 has a wider scope that expanded the definition of insider trading and the authorities of regulators. The CJA came into force to replace the Companies Securities (Insider Dealing) Act 1985. Under Part V of the CJA, the law described three types of acts that constitute insider dealings. This includes: CJA 1993, Part V, s.52(1) and (2).

- a. The act of dealing directly on the basis of insider information.
- b. Any act that encourages and allows another person to be involved in price manipulation of securities based on insider information.
- c. The act of unlawful disclosure of insider information to others

Through the provisions of the CJA 1993, like those of the Criminal Justice Act 1980 and 1985, insider trading is considered a crime. One of the major challenges to this enactment was that it also requires the crime to be dealt with through the same procedure as other crimes, i.e., using the principle of burden of proof contained in criminal laws, which necessitates that for any allegation, the proof must be beyond reasonable doubt. Since this added legislation, it has continued to come under intense criticism because it places an enormous task on the prosecution to prove cases and obtain conviction. Some observers and commentators labelled it as a law that is utterly

---

<sup>484</sup> *ibid*

<sup>485</sup> Alexander, K., Linklater, L., and Bazley, S. (2009). *Market Abuse and Insider Dealing*. Bloomsbury Professional.

unenforceable.<sup>486</sup> Furthermore, the law does not provide a civil remedy, which in itself could be termed as a setback since only a criminal liability can be pursued. However, the provisions of the Proceeds of Crime Act 2000 can be invoked to confiscate and retrieve the proceeds obtained through insider trading

The result of this legal inadequacy led to further calls for a regime of regulation that would cover the investor more appropriately or at least to find a legislation that would complement the loopholes of the CJA. After years of debate through what could be the best approach to both the interest of the market and those of the investors, the FSMA 2000, which was principally meant to compliment the CJA 1993. This new legislation is wider in scope that it remedied some of the deficits of the CJA. It also extends liability to unauthorised persons in addition to those persons who are authorised.<sup>487</sup> A common point of criticism for this legislation is that the market abuse regime operates on the principle of the regular user test, unlike other principles covering other forms of illegal conduct, the test is objective and does not require subjective elements.<sup>488</sup> Although this has eliminated the problems of proof under the CJA 1993, the idea of strict liability on the other hand has attracted some degree of criticism, because of how difficult it is for the law to have the most needed deterrent effect when people commit an offence unintentionally or without knowing. The principle has also failed to put into consideration that there may be different levels of regular users depending on their knowledge and sophistication.

### 5.3.2 The Financial Services and Markets Act 2000 (FSMA)

In a general, the FSMA defines market abuse as behaviour (whether by one person or by two or more persons jointly or in concert) which, amongst others, occurs in relation to qualifying investments admitted to trading on a prescribed market, and which falls within one of the following types of behaviour: insider dealing, improper disclosure, misuse of information, manipulating transactions, manipulating devices, false

---

<sup>486</sup> Dine, J. (2001). *Company Law*, 4th Ed, Palgrave, Basingstoke. See also, *Mackie v HMA* [1994] JC 132

<sup>487</sup> Rider, Alexander and Linklater (2002). *Market abuse and Insider dealing*. Butterworths, London .

<sup>488</sup> Swan, E. (2004) Market Abuse: a new duty of fairness 25(3) *Company Lawyer*, 67- 68. See also, *Winterflood Securities Ltd & Ors v Financial Services Authority* [2009] UKFSM FSM066.

dissemination and distortion and misleading behaviour.<sup>489</sup> Specifically, s118 FSMA sets out the kinds of behaviour that qualify as market abuse which include using information not generally available to the public to manipulate the market, or creating a false or misleading impression to investors, or even the use of specific actions to distort the market.

What this essentially means is that market abuse is a situation where a regular user of the market is put at an unreasonable disadvantage through the use of information not readily available to other market participants, deliberately misleading them impression on either products or services or distorting some aspects of the market.<sup>490</sup> It is however important to stress that the FSMA insists on determining whether such behaviour falls below the expected market standard. The index commonly referred in this context is that FSMA ‘regular user test’, which describes a regular user as a “reasonable person who regularly deals on the market in investments of the type in question”.<sup>491</sup> This also takes into account other variables such as changing market conditions etc.<sup>492</sup> This flexibility suggests that in practice the test is more subjective that it creates uncertainty on what can be best described as reasonable and acceptable behaviour since these are aspects that vary from one person to another.

Essentially, there is the notion that previous legislation was becoming insufficient in addressing many of the types of activity that may constitute the abuse of market and harm the interest of investors. Hence, the FSMA came with broader powers for regulators to deal with offences under the Financial Service Authority (FSA)<sup>493</sup> listing rules especially those involving disclosure and prospectus.<sup>494</sup> In relation to the laws that require the company to give investors sufficient information on company’s status, as contained in section 397 of the FSMA now replaced by section 89-90 of the FSAct, the laws in the UK are similar to those of Saudi that demands for a full disclosure to investors of company’s financial status, its affiliate, directors, securities issued and all

---

<sup>489</sup> See, The Financial Services and Markets Act 2000 (Market Abuse) Regulations.

<sup>490</sup> Swan, E. J., & Virgo, J. (2010). *Market abuse regulation*. Oxford University Press.

<sup>491</sup> s118(10) FSMA.

<sup>492</sup> Rider, A., and Linklater, L. (2002). *Market abuse and Insider dealing*. Butterworths, London p36.

<sup>493</sup> The Financial Services Authority (FSA) was the body responsible for the regulation of UK’s financial services industry from 2001 until 2013 when it was succeeded by the and 2013. Financial Conduct Authority (FCA).

<sup>494</sup> Sections 401 and 402 of FSMA 2000.

relevant information that affects the choice of investment and the status of the company. The legal requirement for disclosure through the provisions of the UK Disclosure and Transparency Rules,<sup>495</sup> especially in Chapters 4-6. This according to the UK Listing Authority is to make securities markets work well by mandating the FCA to monitor market disclosures by issuers by enforcing compliance as well as reviewing and approving prospectuses. The MAD<sup>496</sup> for example, sets out rules to ensure disclosure of dealings in shares by directors and senior management in order to prevent insider trading. Any act that avoids or distorts this information is a liability both in the UK and in Saudi.

The FSMA was therefore conceptualised in a way that these inherent lacuna would be addressed.<sup>497</sup> For example, a significant part of the FSMA 2000 is that it provides the FSA with powers to impose civil penalties, which is an important aspect left out by the previous laws. Similarly, the standard of proof and evidence required under the previous law has made conviction almost impossible and there is therefore the need to review this flaw in order to make the market more secure.

It is important to note that there are other aspects of market abuse covered by the CJA that were subsequently adopted in the FSMA. For example, the CJA 1993 has provisions on 'tippee liability' that was also adopted into s118 of the FSMA is the 'tippee liability'. This refers to situations where insiders encourage others to engage in market abuse and indirectly benefiting from the illegality.<sup>498</sup> The regulation provides that where it is established that such an act occurred and both parties, the giver and receiver of the information do so willingly with the full knowledge and willingness to commit market abuse, then they are deemed culpable.<sup>499</sup>

In reference to market abuse, it is covered as a civil offence under s118 of FSMA. Principally, the Act refers to insider dealing constitutes market abuse where an insider deals, or tries to deal, based on inside information. The indicators of market abuse,

---

<sup>495</sup> This is especially contained in Chapters 4-6.

<sup>496</sup> Council Directive 2003/6/EC on insider dealing and market manipulation.

<sup>497</sup> Filby, M. (2003). Part VIII Financial Services and Markets Act: Filling Insider Dealing's Regulatory Gaps. See also, Barnes, P. (2009). Stock market efficiency, insider dealing and market abuse: the UK experience. *International Journal of Business Governance and Ethics*, 5(1-2), 38-50.

<sup>498</sup> S.123 FSMA 2000

<sup>499</sup> Ibid.

according to the FSMA include, situations where insiders improperly disclose information or where information that is not generally available was used or disclosed to affects an investor's decision about the terms on which to deal.<sup>500</sup> Secondly, is any act of placing orders to trade are done with view to give a false or misleading impression of the supply of, or demand for, one or more investments, raising the price of the investment to an abnormal or artificial level. Thirdly, the regulation also disallows the manipulation of devices where orders are placed for trading which employs fictitious devices or any other form of deception or contrivance.<sup>501</sup> Lastly, the statute considers any act of distortion and misleading behaviour that gives a false or misleading impression of either the supply of, or demand for, an investment; or behaviour that otherwise distorts the market in an investment as an offence of market abuse.

Essentially, insider dealing has been a criminal offence since earlier provisions of the UK market regulations i.e. 1980s. The coming into force of Part V of the Criminal Justice Act 1993 and later the FSMA 2000, broadened the topic and the idea of process and penalties. According to the Act, an individual who possess inside information is deemed to have committed the criminal offence of insider dealing where such information is in the first place price sensitive in relation to shares. Second, where the individual trades or encourages others to trade in the shares or pass such information to others. Lastly, where such trades occur in a regulated market or through a broker.<sup>502</sup> The CJA for example identifies two insider dealing offences, the “dealing” and “tipping-off” offence. The dealing offence is committed by an individual who possess inside information and deals in specified circumstances in price-affected securities in relation to the information.<sup>503</sup> While the tipping-off offence occurs by disclosing such

---

<sup>500</sup> Section 118, FSMA 2000, See also Barnes, P. (2011). Insider dealing and market abuse: The UK's record on enforcement. *International Journal of Law, Crime and Justice*, 39(3), 174-189.

<sup>501</sup> Cumming, D. J., Zhan, F., & Aitken, M. J. (2013). Exchange Trading Rules, Surveillance, and Insider Trading. *Surveillance, and Insider Trading*.

<sup>502</sup> Sec 118 FSMA 2000.

<sup>503</sup> See Slaughter and May. (2011). Market abuse and the definition of inside information. See, <http://www.slaughterandmay.com/media/1522219/market-abuse-and-the-definition-of-inside-information.pdf>

information or persuading others to deal in particular securities and in specified circumstance.<sup>504</sup>

As the existing criminal and regulatory sanctions concerning insider dealing also appear to have certain lapses in addressing all known forms of abusive market behaviour, the FSMA which came into force in 2001 introduced a statutory prohibition on market abuse to supplement the criminal offence of insider dealing and market manipulation.<sup>505</sup> This represented an attempt to further close loopholes to the existing law. Effective policing of the UK market under the old regime proved difficult due to the high criminal law standard of proof. In addition, the regime considered three types of market abuse: misuse of non-public material information, the creation of false or misleading market impressions and market distortions.<sup>506</sup> And no behaviour was considered market abuse unless it was considered contrary to the standards of a hypothetical “regular user”.

In general, the practicality and essence of market regulations is also such that it is meant to serve all investors by ensuring market efficiency and investor confidence against Market abuse. Hence, there is always the requirement to maintain transparency and integrity based on level playing field for all participants.<sup>507</sup> It should also ensure that information asymmetry is minimised. Though it is difficult to imagine absolute equality among investors in their influence and access to information on the securities, regulations and watchdogs try as much to ensure that it is reduced to the most minimal level. To further ensure this aspect of transparency at regional level, the EU has issued a directive i.e., the Transparency Directive Amending Directive (TDAD) (2013/50/EU).<sup>508</sup> The Directives sets out obligations relating to the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.<sup>509</sup>

---

<sup>504</sup> CJA 1993, See also Slaughter and May. (2011). Market abuse and the definition of inside information available at <http://www.slaughterandmay.com/media/1522219/market-abuse-and-the-definition-of-inside-information.pdf>

<sup>505</sup> Sec 118 FSMA 2000.

<sup>506</sup> Ibid.

<sup>507</sup> McGee, R. W. (2008). Applying Ethics to Insider Trading. *Journal of Business Ethics*, 77, 205-217.

<sup>508</sup> See, <http://www.globaldisclosures.com/Latest-News/3158>.

<sup>509</sup> Ibid.

Some scholars observed that insider dealing has the potential of causing instability in the market.<sup>510</sup> The aftermath of using insider information is the way in which it creates significant lack of confidence among potential investors, lessen foreign direct investment into the host market and therefore lessens economic the host markets opportunity to tap from the utility that financial investments present to the community. It is therefore justifiable how nations have risen to confront unregulated market practices and to attempt in putting measures that would maintain sanity, confidence and a transparent playing ground for market participants.<sup>511</sup>

The question however arises as to what are the essential characteristics of insider dealing which distinguish it from acceptable market behaviour.<sup>512</sup> In the decision in *Spector's* case,<sup>513</sup> the Court (Third Chamber) ruled that a person in possession of inside information, who used that information within the meaning of that provision commits an offence but without prejudice to the rights of the defence and, in particular, to the right to be able to rebut that presumption. The question whether that person has infringed the law in relation to insider dealing must be analysed in the light of the purpose of that directive, which is to protect the integrity of the financial markets and to enhance investor confidence, which is based, in particular, on the assurance that investors will be placed on an equal footing and protected from the misuse of inside information.

This question has raised significant debate regarding the possession and use of inside information. It is also to the effect that there followed a rebuttable presumption of use from mere possession, and also on the relevance of information and how lethal it is to other market participants. Moreover, it also raises questions on the specificity or the precise nature of such information. This was the position of the tribunal in trying to answer some of the complex questions in the *Massey* case. Although *Massey* argued

---

<sup>510</sup> Ribstein, L. E. (2002). Market vs. regulatory responses to corporate fraud: A critique of the Sarbanes-Oxley Act of 2002. *J. Corp. L.*, 28, 1. See also, Alexander, K., Linklater, L., & Bazley, S. (2009). *Market Abuse and Insider Dealing*. Bloomsbury Professional.

<sup>511</sup> Dignam, A., and Lowry, J. (2006). *Company Law* .4th Edn., Oxford University Press.

<sup>512</sup> Jesper-Lau, H. (2009). What constitutes insider dealing?—The Advocate General's opinion in Case C-45/08, *Spector Photo Group*. *International and Comparative Corporate Law Journal*, Forthcoming. SSRN: <http://ssrn.com/abstract=1499093>

<sup>513</sup> Case C-45/08, *Spector Photo Group NV, Chris Van Raemdonck v. Commissie voor het Bank-, Financie- en Assurantiewezen (CBFA)*, Judgment of the European Court of Justice (Third Chamber) of 23 December 2009, nyr.

that the public is well aware of the information about Eicom's desire to sell its shares at a discounted rate, the tribunal distinguished the offer to Mr. Massey as "in line with but not the same as" the publicly available information, meaning that knowing more of the same type of information which is publicly available could make it "inside". Another question raised was whether the information was precise under s118C(5)(b)?, this the tribunal said it was precise and that if the public knew of such precise information, it could have affected the share price.<sup>514</sup> These are some of the complications when it comes to proving the different kinds of facts when it comes to market abuse. As Titcomb asserts in the famous 'Operation Tabernula',<sup>515</sup> he says it is a crime that is notoriously hard to spot, and very difficult to prove.<sup>516</sup> "No one piece of evidence is ever likely to be a smoking gun; instead, investigators have to trawl through thousands of 'suspicious transactions' – trades from shortly before a market-moving event that one could have profited from – and hope a pattern emerges."<sup>517</sup>

#### 5.4 MAD and MAD II

A major distinction between regulations in Saudi and the UK is that financial products and service in the UK are governed by EU laws as well domestic legislation. As a matter of comparison to the regional aspects of the GCC and the effect of Saudi, the EU has an integrated market policy that is quite different to that of the GCC. Hence, the market system in the UK is not only a matter for the frontiers of the UK but also one that is affected by EU legislations. The pioneer regulation conceptualised for the Union was the MAD, which was meant to deal with market abuse and to also harmonise the rules of market at the European regime. Preamble 12 to MAD elaborates this position stating that, "The objective of legislation against insider dealing is the same as that of legislation against market manipulation: to ensure the integrity of Community financial markets and to enhance investor confidence in those markets".<sup>518</sup>

---

<sup>514</sup> *David Massey v The Financial Service Authority* [2011] All ER (D) 95 (Feb) (FIN/2009/0024). See also, <https://www.kingsleynapley.co.uk/news-and-events/blogs/regulatory-and-professional-discipline-blog/the-regulator-insider-trading-knowing-where-to-draw-the-line>

<sup>515</sup> Operation Terbaluna is one of UK's biggest insider trading investigations.

<sup>516</sup> See, <http://www.telegraph.co.uk/finance/financial-crime/11483111/Operation-Tabernula-The-story-of-the-biggest-insider-trading-investigation-in-UK-history.html>.

<sup>517</sup> Ibid.

<sup>518</sup> Ferrarini, G. A. (2004). The European Market Abuse Directive. *Common Market Law Review*, 41(3), 711-741.



One of the significant aspect for instance is the EU Directive that emphasis on appropriate *administrative* measures to be taken by member states to ensure *administrative* sanctions are imposed for non-compliance with prohibitions set out in the Directive, and to ensure that these measures are effective, proportionate and dissuasive'.<sup>519</sup>

What is obvious about the contemporary development in market regulations in EU member states is that the law is becoming predominantly European-based, and EU directives are increasingly becoming the primary source of the law for many member states. This is evident in the establishment of the MAR, which the European Commission says was due to the uneven implementation of MAD 1. What is also evident is that the scope of European laws on market regulations are becoming wider and more stringent, beyond insider trading and market manipulation, to include aspects of ad hoc publicity.<sup>520</sup> This development according to Siems is in line with international developments such as the IOSCO. A close observation of the Directives clearly shows that at the first level, the MAD 2003/6/EC consist of the main legal framework while the second level i.e. Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, and the Regulation (EC) No 2273/2003 are mainly on the technical aspects of the Directives. The final level is the one that deals with compliance.<sup>521</sup>

Essentially, this transnational legislation was conceptualised to regulate the markets across a region that share political, economic and geographical ties. It is also meant to promote and safeguard competition in a competitive global market that is increasingly becoming proliferated with different kinds of products and service traded in different kinds of platforms and technology.

---

<sup>519</sup> MAD 2003, Commission Directive 2003/124/EC of 22 December 2003. See also, Dejmek, P. (2008). EU Internal Market for Financial Services-A Look at the First Regulatory Responses to the Financial Crisis and a View to the Future, *The. Colum. J. Eur. L.*, 15, 455. See also, Wymeersch, E. (2010). The institutional reforms of the European Financial Supervisory System, an interim report. *Ghent Univ. Financial Law Institute Working Paper*, (2010-01).

<sup>520</sup> For example, Directive 2001/34/EC of the European Parliament and the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, Art 81.

<sup>521</sup> See, [http://ec.europa.eu/intenal\\_market/company/infringements/index\\_n.htm](http://ec.europa.eu/intenal_market/company/infringements/index_n.htm).

What succeeded MAD was the Market Abuse Regulation (MAR), and the Directive on Criminal Sanctions for Market Abuse (CSMAD)<sup>522</sup> which are together referred to as MAD II. These two instruments of the European Union are meant to define the future of market abuse across as they become applicable to all EU member nations in July 2016. MAD II came into force in July 2014 as a successor to MAD. This new law covers what was in MAD, and also expanded the area of regulation to regulate new products. It is also meant to regulate emerging market practices such as emission allowance trading, high frequency and algorithmic trading.<sup>523</sup> But the UK has issued a statement saying it would not subscribe to this legislation in relation to justice and home affairs matters such as criminalisation of Market Abuse. The reason given by the UK is that it already has regulatory rules that have exceeded those of the CSMAD.<sup>524</sup> Yet, it is important to note that despite its opting out, UK is obliged to follow MAR, which will come into effect in July 2016 and will supersede the provisions of Section 118 of the FSMA and the provisions of the FCA Handbook MAR block.

## 5.5 Conclusion

Market liberalisation has come with not only the difficult choice of compelling market participants to abide by some form of strict regulations imposed by governments, that is largely argued to be crucial in maintaining transparency and ensuring ethical engagements between investors and companies. Evidently, leading markets like the UK have detailed laws and have gone through a great deal of reforms than markets in emerging regimes such as Saudi Arabia. The enormity of laws and bodies responsible for markets are also different. These differences are largely a reflection of the size and dynamics of products and services available.

Tracing the root of the development of financial markets and their regulatory laws, the Saudi market regime is one that came in the 1930s, but it was until 1984 when was

---

<sup>522</sup> In 2014 the Market Abuse Regulation (MAR) and the Directive on Criminal Sanctions for Market Abuse Directives (CSMAD) were published, with each having an implementation date of 3 July 2016. MAR applies directly in each EU member state without requiring states to produce laws that implement MAR's provisions. CSMAD requires each Member State to implement legislation to ensure that market abuse is a criminal offence which can be effectively punished.

<sup>523</sup> Alexander, K., & Maly, V. (2015). The new EU market abuse regime and the derivatives markets. *Law and Financial Markets Review*, 1-8.

<sup>524</sup> Moloney, N. (2010). EU financial market regulation after the global financial crisis: "more Europe" or more risks?. *Common Market Law Review*, 47(5), 1317-1383.

termed as the fifth development plan started gathering momentum and saw a new phase in the development of capital market in the kingdom. A major reform for the development and diversification plan was the establishment through Royal Decree Number M/3 of July 2003 of the CML. This was a giant leap for the Saudi capital market that brought in a new constitutive law for the securities industry. Although the Saudi capital market may seem to be among the least open markets in the Gulf Co-operation Council (GCC) and among those with limited foreign participation, the body of rules contained in the CML exposed Saudi's desire for diversification. What became obvious to most investors is the emergence of new laws that will regulate registration, listing and operation of stocks, securities and public offers. The provisions of the CML is an upward development from other previous laws such as the Saudi Law against Deception in Trade of 1984, the advertisement regulations law of 1992, Merger and Acquisition Regulations, Real Estate Investment Funds Regulations.

Like most regulatory frameworks in other jurisdiction, the CML was largely meant to create a safe investment environment and ensure adherence to the standards of transparency and legality. Hence, it enacts provisions that outlaw any intentional act in the market that creates false or misleading impression on values of products and services, referring to such acts as market abuse. It also go further to states that insider trading through information obtained by an insider that is not available to the general public, and used to take advantage of the market and make gains is punishable under the law. These provisions are quite similar to what is contained under the UK laws, particularly the FSMA.

Regulations under the Saudi regime also cover aspects of both private and public offering as in the UK. But the CML, unlike the laws in the UK, did not provide a comprehensive definition of 'securities'. Instead, it gives a broader description of securities by identifying them alongside other schemes in the financial market. However, both regimes emphasis on transparency and disclosure and refuse any act that amounts to manipulating the market. But at the same time, the Saudi rules allow authorities to waive certain disclosure requirements. The Saudi regime also does not allow for legal suits to be instituted before any civil court in the Kingdom. This is a clear departure from the UK laws that allows for both criminal and civil actions for conviction and restitution respectively. In Saudi however, disputes on securities

between participants cannot be instituted before conventional courts, remedies can only be sought through the Committee for the CRSD and appeals lie only with the CRSD Appeal Panel. The CML also contains statutes of limitation i.e. for issues arising from the violation of CML sanctioned disclosure of information, there is a limit as to the time allowed for investors to bring an action.

Another aspect that differentiates the two regimes is that the UK has different bodies that have a stake in the financial market, ranging from ensuring transparency to watching the behaviour of banks and insurance companies and indeed the nature and types of products in the market. The Saudi on the other hand has only the CML and on the other hand the SAMA (which deals with banking laws). Another important aspect that differentiates market laws in the two jurisdictions is the influence that other regional legislations have on domestic ones. In the UK, markets are also affected by EU laws, but in Saudi, the market rules are not affected by other prevailing or concurrent laws.

In the end this part was able to show evidence that both regimes have commonalities on what constitute market abuse but differ in the way different strands of market abuse are regulated. For example, evidence shows that all aspect of investigation and sentencing are dealt with by subsidiaries of the CMA (which is a body established under the CML), including criminal aspects of the financial market. This is distinguishable from the concept in the UK where regular courts have jurisdiction over criminal offences relating to the financial market and the civil and criminal aspects of market abuse are dealt with often differently. The chapter also shows that the size of the two markets plays a significant role in the way these laws and regulations are reviewed and enforced. There are also dynamics in the character of the market such as the presence of complex products and services that needed certain kinds of regulations. Moreover, the chapter has shown that geographical legal developments such as the EU laws have effect on the UK while the Saudi regimes remains autonomous from any such supranational legislation.

## **Chapter Six**

### **The Nature and Trajectories of Regulatory Authorities: Saudi Arabia and the UK**

#### **6.1 Introduction**

In general, regulatory bodies both in Saudi Arabia, the UK and other parts of the world are meant to compel transparency, ensure effective and ethical competition and to prohibit market abuse. The nature of regulations and enforcement to ensure the protection of both the suppliers of finance, the consumers of products and those that want return for their investment has been an important part of the debate on financial markets. Essentially, the interests of all these parties demands the concerted effort of institutions and experts to watch the market and draw formidable framework, especially in a world that is becoming saturated with all kinds of financial products and technological innovations that are increasingly making markets become even more interconnected across different frontiers. While the Saudi system has not witnessed so much reformation in terms of agencies and institutions, the UK market has gone through a great deal of challenges and changes, including the splitting of responsibility between different institutions.

What is obvious about market regulatory agencies is that their effectiveness enhances confidence in the market and their ineffectiveness results in not only lack of confidence but also the proliferation of unethical market behaviour, which increases uncertainty and illegality. Many scholars argue that greater protection leads sustainable market growth as against weaker regulation, which may lead to collapse. As a result, there appears to be consensus across many regimes that the best strategy for avoiding market abuse is by putting in place extensive regulations on existing market products and services and to also ensure enforcement and penalty for bad behaviour.

This chapter intends to examine the structure of the Saudi and UK regulatory institutions, their transition from past to the present and the challenges and contingencies of overseeing the market and ensuring the safety of investments against abuse and manipulation.

## 6.2 The Capital Market Authority (CMA)

Until 2001, trading on the Saudi stock exchange suffered from absence of a formal trading, clearing and settlement platform. The years after 2001 saw some concerted effort in developing the prerequisite infrastructure for a modern market. Many observers regarded the establishment in 2003 of the CMA as Saudi's independent market regulator as a turning point in capital market activities in the Kingdom.<sup>525</sup> The CMA replaced the Saudi Arabian Monetary Agency (SAMA), which was the body that was responsible for regulating and monitoring activities in the Saudi market, but that which many see as weak and inefficient.<sup>526</sup> The establishment of the CMA proved to be a giant leap from the SAMA. The move to establish a new framework through CMA is undoubtedly a phenomenal move towards redefining and standardising the Saudi capital market, i.e. it is a conspicuous departure from the previous history of weak legal and regulatory framework. Historically, Saudi market has never had an adequate and robust regulatory system. According to research by Aljazira, the establishment of the Saudi stock Market (or Tadawul) in October 2001 brought in better infrastructure as well as the “much needed physical market place for trading, clearing and settlement of capital market transactions.”<sup>527</sup>

Essentially, the provisions of the CML have empowered the CMA to issue regulations to protect the interest of investors in the Saudi market. Since it began operation, the CMA has continued to issue rules that deal with some of the most important aspects of the market. The emergence of a more overarching regulatory authority became a factor that opened up a new era in the activity of markets in the Kingdom. The body continued to develop regulations that deal with investors' protection and market ethics. The CMA has since continued to develop in line with its functions to regulate and develop the Saudi Arabian Capital Market by issuing the required rules and regulations for the successful implementation of the provisions of CML. The objectives are to create an appropriate investment environment, boost confidence, and reinforce transparency and disclosure standards in all listed companies, as well as protecting investors and dealers

---

<sup>525</sup> The Financing Role of the Saudi Capital Market Promising Prospects. *Aljazira group Research Department Economic Reports* (2010)

<sup>526</sup> Al-Suhaibani, M., and Kryzanowski, L. (2001, April). Limit vs. market order trading on the Saudi Stock Market. In EFMA 2001 Lugano Meetings.

<sup>527</sup> The Financing Role of the Saudi Capital Market Promising Prospects. *Aljazira group Research Department Economic Reports* (2010)

from illegal acts in the market.<sup>528</sup> Within the scope of its' responsibilities, the CMA regulates various issues of corporate governance, market conduct, mergers and acquisitions, and laws that facilitate introduction and application of financing tools such as IPOs, Sukuks and mutual funds.<sup>529</sup> This went on without must progress until 2007, when the Council of Ministers converted the main Saudi Stock market into a state-owned joint stock company.<sup>530</sup> The move was aimed at strengthening the capital market regulatory framework by providing more autonomy in the market. A general overview of the duties of the CMA indicates that the CMA is responsible for:

Regulating and monitoring issuance of, and trading in securities, authorising market intermediaries, enforcing corporate governance, transparency and other norms, promoting education of investors and issuers, developing procedures that mitigate risks associated with securities transactions, reviewing interim and annual financial statements of listed companies and monitoring their publication on the Tadawul website.<sup>531</sup>

In the quest to have a coherent and efficient institutional character, the CMA was divided into different departments.<sup>532</sup> The departments include: Market Supervision; Corporate Finance; Authorization and Inspection; Research and Investor Awareness and the Department for General Administration and Enforcement.<sup>533</sup> Research however shows that the development of a strong regulatory framework in Saudi is relatively slower than what has been obtained in other emerging market, especially in the Gulf and Asia Pacific.<sup>534</sup>

---

<sup>528</sup> Role of the CMA. See, <http://www.cma.org.sa/En/AboutCMA/Pages/default.aspx>.

<sup>529</sup> Al Elsheikh, A. A. A., and Tanega, J. (2011). *Sukuk* structure and its regulatory environment in the Kingdom of Saudi Arabia. *Law and Financial Markets Review*, 5(3), 183-200.

<sup>530</sup> Alshogeathri, M. A. M. (2011). Macroeconomic determinants of the stock market movements: empirical evidence from the Saudi Stock market (Doctoral dissertation, Kansas State University).

<sup>531</sup> The Financing Role of the Saudi Capital Market Promising Prospects. *Aljazira group Research Department Economic Reports* (2010)

<sup>532</sup> Abraham, A., Seyyed, F. J., and Alsakran, S. A. (2002). Testing the random walk behaviour and efficiency of the Gulf stock markets. *Financial Review*, 37 (3), 469-480.

<sup>533</sup> Mahayni, Z. (2013). An Analysis of Capital Market Regulation in Saudi Arabia (Doctoral dissertation, University of Leicester).

<sup>534</sup> The Financing Role of the Saudi Capital Market Promising Prospects. *Aljazira group Research Department Economic Reports* (2010).

### 6.2.1 Structure of the CMA

The CMA is the most powerful regulatory body in the Saudi market with its powers contained in the provisions of the CML.<sup>535</sup> The administrative structure of the CMA consist of a board of commissioners, appointed by a Royal Decree for a five year term (renewable ones), and who are directly answerable to the prime minister of the Kingdom.<sup>536</sup> In the administrative structure, there are five main departments and twenty-eight sub-departments. The main departments/offices are office of the chairman, office of the general secretary, legal affairs, public relations, and the internal audit office.<sup>537</sup> The sub-departments include: regulatory, investigation, administration, research, and supervision.<sup>538</sup>

In general, the CMA is responsible for all the laws governing the Saudi capital market. As part of its effort to achieve this objective, the CMA, through the provisions of the CML, created a joint stock company under which is the Saudi Stock Exchange (SSE), the only institution, authorised under the law to carry out trades in securities.<sup>539</sup> Moreover, the CMA has the role of investigation and adjudication, making it the police and the judge of the capital market.<sup>540</sup> The only limitation to the powers and activities of the CMA are those prescribed under Article 4 of the CML, which states clearly that the CML cannot engage in lending any funds, acquiring, owning or issuing any Securities or; have any special interest in profiting from the market through any kind of project.<sup>541</sup>

### 6.2.2 Role of the CMA

#### (a). Regulatory

Since its establishment, the CMA has issued ten statutes that regulate all the relevant issues for market participants and their relationship with the authorities.<sup>542</sup> The direct role that the CMA plays is pivotal to the daily functioning of the market. In the quest to

---

<sup>535</sup> Article 2 CML

<sup>536</sup> Article 7 CML

<sup>537</sup> Al-Hussain, A. H. (2009). *Corporate Governance Structure Efficiency and Bank Performance in Saudi Arabia*. ProQuest.

<sup>538</sup> *ibid*

<sup>539</sup> Article 20 of the CML

<sup>540</sup> Article 2(e) CML

<sup>541</sup> Article 4(b) CML

<sup>542</sup> CMA Board Resolution No. 1-39-2008, 3/12/1429H



ensure that these objectives are achieved, the CMA serves as an administrator, dispute resolution institution and a legislative body. Part of the numerous role played by the CMA, especially those powers as provided under the Article 5 of the CML which include making daily market activity reports and bringing legal proceedings before the CRSD against any party violating the regulations of the CML.<sup>543</sup> It also has powers to receive investors' complaints and follow up on the implementation of the decision of the CRSD and to also investigate issues referred to it by a competent department relating to violations of the CML. The powers of the CRSD as provided under the CML include the powers to investigate and settle complaints and suits, including the powers to issue subpoenas and decisions, as well as impose sanctions and order the presentation of evidence and documents.<sup>544</sup> CRSD also has the right to issue a decision awarding damages and request to revert to the original status, or issue another decision as appropriate that would guarantee the rights of the aggrieved.

The CMA also regulates the sale of securities through laws laid down by the CML. These transaction falls under that Listing Rules and Offers of Securities Regulations.<sup>545</sup> The CMA ensure that all securities to be sold be a company were duly offered to the public in accordance with the guiding regulations of the CML. Essentially, these offers are regulated and done in two ways. The first is the primary offer or primary distribution, which is done mainly through an underwriting agreement between an issuer and broker or dealer.<sup>546</sup> The second one is the secondary offering, which "happens when the seller is not the issuer, but a shareholder or group of shareholders that sells a previously issued stock. The proceeds of the sale are not used to raise capital; they go to the selling shareholder."<sup>547</sup> In all of these offerings, the CMA plays a central role in ensuring that the rules of the market are followed, and emphasises on the principles of transparency and fairness.

---

<sup>543</sup> Article 25 (a) CML.

<sup>544</sup> Ibid.

<sup>545</sup> Beach, J. W. (2005). Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets, *The. Stan. J. International L.*, 41, 307.

<sup>546</sup> Wilson, R. (2006). Regulatory challenges posed by Islamic capital market products and services. *Centre for Middle Eastern and Islamic Studies*, University of Durham, UK.

<sup>547</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The. Ann. Surv. International and Comp. L.*, 18, 115.

Another important regulatory role of the CMA is that which gives rise to damages under the disclosure rule. The law allows investors to institute actions where they were misled by a company based on the information contained in a prospectus.<sup>548</sup> The pursuance of a safe and transparent market for securities has made the CMA to explore necessary areas for reforms that will develop the market further. Since it was established, and especially from the beginning of 2004, the CMA had continued to issue several regulations to protect and safeguard the market and its participants. In 2006 for example, regulations relating to real estate investment and corporate governance were issued.<sup>549</sup>

**(b). Publicity and public awareness.**

Another important role played by the CMA is in ensuring that it reaches out to the public with all the important information regarding the Saudi market. This includes the role of ensuring that all companies make their information public through both annual and periodic reports.<sup>550</sup> Other publicity roles include investor relations through responding to inquiries from the public. But scholars have raised a very serious observation, particularly regarding decisions by the CRSD, which are not open to the public.<sup>551</sup> The CMA and CRSD are seen by some critics as not adhering to the principle of openness when it comes to independent research or inquiries regarding decisions made or taken, “despite the fact that the CRSD has disposed of hundreds of cases no one outside the circle of litigants or the judges themselves knows how things go inside the judges’ chamber.”<sup>552</sup> This lack of transparency as to what or how the CRSD adjudicates and finalise disputes is a challenge to the concept of a free and open market.<sup>553</sup> Jurisprudentially, the public, who have an interest in the market, also have a legitimate interest to know how disputes and violations are being adjudicated. Since these cases are not dealt with in open courts, then the CMA should consider provisions that will either make these decisions public or compel the CRSD to answer any

---

<sup>548</sup> Article 55(a) CML.

<sup>549</sup> The Saudi Arabian Capital Market Regulation, Royal Decree No. M/30 of 2nd Jumada Thani 1424 Hejra corresponding to 31st July 2003 Ramady, M. A. (2010). *The Saudi Arabian economy: Policies, achievements, and challenges. Springer Science and Business Media.*

<sup>550</sup> CMA Annual Report, 2007.

<sup>551</sup> Beach, J. W. (2005). Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets, *The. Stan. J. International L.*, 41, 307.

<sup>552</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The. Ann. Sur. International and Comp. L.*, 18, 115.

<sup>553</sup> Al-Kahtani, F. S. (2014). Current Disclosure and Transparency Practices in Saudi Corporate Governance. *Arab Law Quarterly*, 28(2), 176-192.

inquiries into how the case was settled. As a matter of comparison and recommendation, the CMA through the CRSD or in another form may as well explore the possibilities of publishing semi-anonymized accounts similar to the Financial Ombudsman Service in the UK. The current practice of releasing a brief detail of the outcome of their decision to media or on website without giving a thorough detail about the entire case is far less than the standards of transparency required in the event of controversial and unethical market behaviour. For example, in February 2010, a decision of the CRSD was published simply stating that, under its resolution, and due to several violations of the Capital Market Law and its Implementing Regulations, the CMA Board of Commissioners issued a decision to revoke the license granted to Ernst and Young Saudi Arabia Consulting Limited based on the Capital Market Law.<sup>554</sup> Scholars, argue that this kind of lack of transparency had to be addressed in order to promote public confidence in the market and in the way the CRSD conducts its duties.<sup>555</sup>

### **(c) Swap agreements as means of attracting foreign investment.**

Opening the Saudi market for foreign participation is a landmark development for the Kingdom. Although the market capitalisation as of July 2007 was around 480.3 billion dollars, it was lacking in lack of foreign participation.<sup>556</sup> Tadawul was largely closed to foreign capital as foreign investors were only allowed to invest in the stock market through the Saudi mutual funds.<sup>557</sup> This some observers ascribe to the Kingdom's apprehension to past events that destabilised East Asian economies in the 1997 Asian financial crisis i.e. the outflow of 'hot' money. Yet, the fact that Saudi wants to open its market to the world became a reason to start devising ways through which foreign investors could be wooed into the domestic market.<sup>558</sup> In trying to attract foreign investors and create certain products similar to the ones in western markets, the CMA, in August 2008, issued a resolution to introduce a model, which saw the

---

<sup>554</sup> Revoking the Securities Business License of Ernst & Young Saudi Arabia Consulting Limited contained in the CMA Announcements published on 14/03/2010. See, [http://cma.org.sa/En/News/Pages/CMA\\_N\\_513.aspx](http://cma.org.sa/En/News/Pages/CMA_N_513.aspx)

<sup>555</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The Ann. Surv. International and Comp. L.*, 18, 115.

<sup>556</sup> Salinas, F. (2008). Harmonisation Is the Key to Success. *International Fin. L. Rev.*, 27, 50.

<sup>557</sup> RSC 32.

<sup>558</sup> Robertson, C., Al-AlSheikh, S., and Al-Kahtani, A. (2012). An Analysis of Perceptions of Western Corporate Governance Principles in Saudi Arabia. *International Journal of Public Administration*, 35(6), 402-409.

implementation of a new law allowing foreign investors to buy shares listed in the Saudi market by entering ‘swap agreements’.<sup>559</sup> Essentially, under this new law, licenced Saudi investors, were allowed to enter into a special kind of agreement and arrangement in which a Saudi investor retains legal ownership of the shares while transferring economic benefits to foreign investors.<sup>560</sup>

As discovered in research by the Aljazira group, the foreign investor pays the full investment amount at the outset to authorised licensed intermediaries, who, in turn, would purchase the shares of a particular company, “at the end of the specified period, the authorized person would sell the shares and transfer the proceeds plus the economic benefit or losses. Other benefits, such as the right to receive dividends, are also transferred to foreign investors.”<sup>561</sup> These arrangements according Alzahrani *et al.*, give the foreign investors the right to benefit from the equity, but not to enjoy voting right or any other rights as the dealers retain legal ownership of the shares.<sup>562</sup> But this limitation of rights is seen by some commentators as a downside to the long term goals of the Saudi capital market.

Among the various types of swap agreements, equity swap is seen as the most advantageous in the Saudi market. It is a special type of swap that was first allowed to be explored by Morgan Stanley Saud Arabia.<sup>563</sup> The bank entered an equity swap with foreign investors. Later other banks such as HSBC were authorised to engage in this type of contracts. Commenting on how this is important to the Saudi market, Aljazira research states:

It is likely to provide foreign investors a platform to access the Saudi stock market, the largest bourse in the Arab world in terms of market capitalization. The swap agreement would send a strong signal highlighting the Kingdom’s openness to foreign investments and motivate foreign investors to enter the

---

<sup>559</sup> Available at [http://www.aljaziracapital.com.sa/report\\_file/ess/eco-4.pdf](http://www.aljaziracapital.com.sa/report_file/ess/eco-4.pdf)

<sup>560</sup> The Financing Role of the Saudi Capital Market Promising Prospects. *Aljazira group Research Department Economic Reports* (2010)

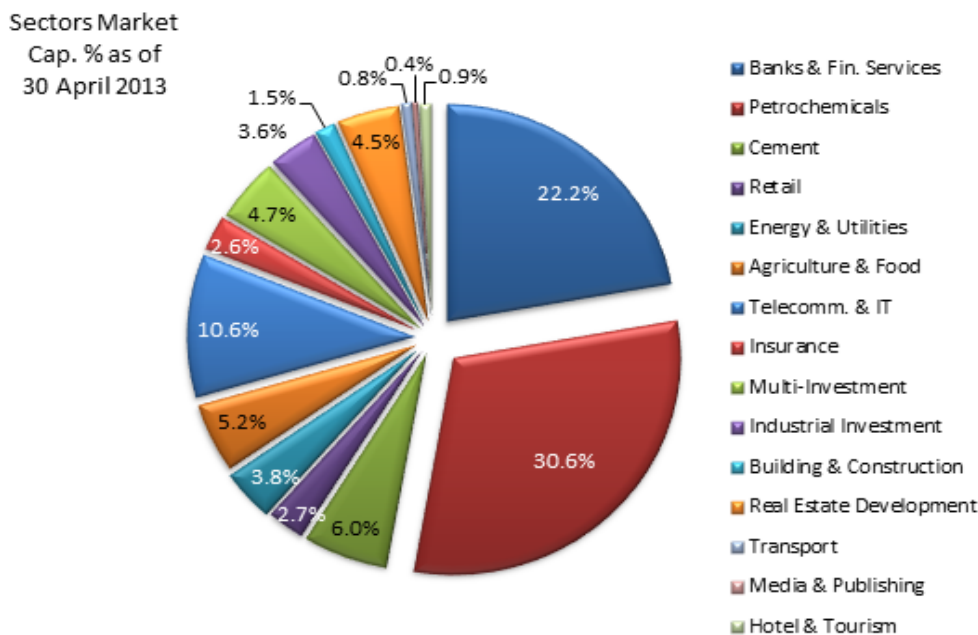
<sup>561</sup> Ibid.

<sup>562</sup> Alzahrani, A. A., Gregoriou, A., and Hudson, R. (2013). Price impact of block trades in the Saudi stock market. *Journal of International Financial Markets, Institutions and Money*, 23, 322-341.

<sup>563</sup> Ramady, M. A. (2010). *The Saudi Capital Market*. In *The Saudi Arabian Economy*, (pp. 145-177). Springer US.

Saudi stock market. Foreign investors are also expected to be encouraged by the decision to impose no tax liability on capital gains.<sup>564</sup>

Because of the advantages that the swap agreement poses, it has increased over the years. This according to Aljazira research is evident of relative growth of swap purchases, which increased from 45 million dollars in 2008 to 275 million dollars in 2010.<sup>565</sup> Indicators seem to suggest that the Saudi market is still growing especially in the areas of banking and finance and insurance. See the table below:



Source: World Federation of Exchange Interview Report April 2013.<sup>566</sup>

Some of the obvious advantages of a swap agreement is that it would “increase the depth and market efficiency as both short term and long term agreements would allow greater role to institutional investors in the Saudi capital market which is currently dominated by retail investors.”<sup>567</sup> It would also encourage international broking and investment houses to have more interest in the Saudi market.<sup>568</sup> Moreover, because the

<sup>564</sup> The Financing Role of the Saudi Capital Market Promising Prospects. *Aljazira group Research Department Economic Reports* (2010).

<sup>565</sup> *ibid.*

<sup>566</sup> See, <http://www.world-exchanges.org/insight/views/wfe-interviews-saudi-stock-exchange-tadawul>.

<sup>567</sup> *Ibid.*

<sup>568</sup> Robertson, C., Al-AlSheikh, S., and Al-Kahtani, A. (2012). An Analysis of Perceptions of Western Corporate Governance Principles in Saudi Arabia. *International Journal of Public Administration*, 35 (6), 402-409.

current law under the CML only allows foreign investors to hold shares in the Saudi market for a maximum of four years, recourse to swap purchases has become a viable alternative for foreign investors.

When one takes into account the nature of these kinds of financial products and services and how they are traded in the UK and other western markets, it is evident that despite the sources of regulation and insistence on transparency in the market, a number of these finances present inherent challenges if they are to be traded in Saudi market. Examples of these include options, futures, and contracts for differences (swaps) which on the standard of Shari'ah will be considered as lacking transparency. Although in electronic based transactions there are immediate reporting on the executable bid and offer, the complete nature of these transactions is often not disclosed.<sup>569</sup> As Duffie, Gârleanu, and Pedersen, argue, some limit-order-book markets allow “icebergs,” components of a limit order that have undisclosed quantities, that allows those submitting icebergs to reduce inference by market participants which could potentially worsen the order submitter’s ultimate average execution price.<sup>570</sup> They also stated that financial institutions could allocate orders to off-exchange “dark pools,” where they are crossed at prices that were recently executed on exchanges; as individual trades in dark pools are not normally disclosed.<sup>571</sup> Often, they are subject to high frequency traders’ manipulation of prices particularly where large block of shares are being traded. In relation to OTCs, it is common to find buyers and sellers negotiating privately, mostly with limited knowledge of current available prices from other parties. Scholars pointed out that the opaqueness of the OTC market created by intermediating brokers and dealers often puts investors in the dark about the most attractive available terms and even about whom to contact for attractive terms.

To minimise this risk, the European Market Infrastructure Regulation (EMIR) agreed in 2009 that all standardised OTC derivative contracts must be cleared via central counterparties until the end of 2012. Fulfilling this G-20 commitment of 2009, the regulation which came into force on 16 August 2012 is directly applicable in Member

---

<sup>569</sup> Bichler, M. (2000). Trading financial derivatives on the Web—an approach towards automating negotiations on OTC Markets. *Information Systems Frontiers*, 1(4), 401-414.

<sup>570</sup> Duffie, D., Gârleanu, N., & Pedersen, L. H. (2005). Over-the-Counter Markets. *Econometrica*, 73(6), 1815-1847.

<sup>571</sup> Ibid.

States. EMIR sets out to increase stability within and achieve effective regulatory oversight of the OTC derivative markets uses a three-stage approach to achieve regulatory oversight of OTC derivatives by introducing greater transparency, reducing counterparty credit risk as well as operational risk. In August 2015, ESMA published four reports on how the EMIR has been functioning and providing input to the European Commission's EMIR Review. These reforms were in response to how these types of transactions have previously affected the financial market.

No doubt, the recent reform proposals on market regulation at the international (G20), US and EU level have brought important initiatives to improve transparency, regulating over the counter trade, installing position limits and strengthening regulatory authorities.<sup>572</sup> However, the presence of broad exemptions especially those involving commercial traders and position limits have only marginally solved the problems. This according to Staritz and Küblböck is because, any regulatory framework that is meant to address the underlying problems must be pro-active on the risks of failure and adopts regulations that take into account the multiple and interrelated roles of financial and large commercial traders that are often engaged in speculative derivative.<sup>573</sup> Taking these into context, it is evident that in comparison to the Saudi market and its strict regulations on speculative trading and transparency regime, it presents a more secure alternative to investors. Although, big trading companies in the UK are bound to make enormous profit from speculative trades and OTCs, it also creates a regime that is risky to the market and full of uncertainty that may also cause enormous loss. Speculative trading also increases the potential for insider trading.<sup>574</sup>

### 6.3 The UK regime.

The market regime in the UK has both similarities and differences with that of Saudi. While the substantive goals are the same, especially when it comes to dealing with market abuse, the structure of the institutions are different. One major distinction is that

---

<sup>572</sup> See FSB report on implementation and effects of the G20 financial regulatory reforms. See, <http://www.fsb.org/2015/11/fsb-publishes-report-on-implementation-and-effects-of-the-g20-financial-regulatory-reforms/>

<sup>573</sup> Staritz, C., and Küblböck, K. (2013). *Re-regulation of commodity derivative markets: Critical assessment of current reform proposals in the EU and the US* (No. 45). Working Paper, Austrian Foundation for Development Research (ÖFSE).

<sup>574</sup> Manove, M. (1989). The harm from insider trading and informed speculation. *The Quarterly Journal of Economics*, 823-845.

since the abolition of the FSA, there was a split in function with FCA dealing with the micro-prudential and the Prudential Regulation Authority (PRA) dealing with the macro-prudential in regards regulatory role in the UK. This is while Saudi still maintains the CMA as the sole regulator for markets and even for the role of attracting foreign investments to the kingdom. The UK on the other hand has a regime that is susceptible to changes, especially at a time when the regional legislations of the EU are becoming increasingly relevant. For example, the arrangement that came at the wake of the split of the FSA where the remainder of the FSA's functions were transferred to the PRA, which in terms of the FSAct 2012 appears to be an independent macro-prudential regulator, but in fact is a body corporate and a subsidiary of the BoE. This restores many of the functions of the BoE that were lost not by the Banking Act 2009, but the Bank of England Act 1997 that transferred its regulatory functions to the FSA.<sup>575</sup>

### 6.3.1 From the FSA to FCA

The size and scale of monetary and investment institutions in the UK suggests how the financial markets is characterised by the need for constant, sometimes overarching reforms to deal with the challenges of a market that is one of world's largest. To accommodate the growth as well as innovations and emerging products and services, market regulators, investors and consumers are constantly driving new ideas and reforms.<sup>576</sup> The case in Saudi Arabia is different, largely due to the size of the market, the resolve to give the financial industry more attention and the fact that it is still at its formative stage compared to the UK.<sup>577</sup> Market regulatory bodies have been in the UK financial system for decades, but the global financial crisis of 2007/2008 brought to the fore some critical questions that led to one of the defining moments of the powers and effectiveness of these bodies.<sup>578</sup> The law was subsequently reviewed based on many proposals, recommendations and criticisms.

---

<sup>575</sup> Ferran, E. (2011). The Reorganisation of Financial Services Supervision in the UK: An Interim Progress Report. *University of Cambridge Faculty of Law Research Paper*, (49).

<sup>576</sup> Gieve, S. J. (2006). Financial System Risks in the United Kingdom-Issues and Challenges. *Bank of England Quarterly Bulletin*, Fall.

<sup>577</sup> Antoniou, A., Ergul, N., and Holmes, P. (1997). Market Efficiency, Thin Trading and Non-linear Behaviour: Evidence from an Emerging Market. *European Financial Management*, 3(2), 175-190. See also, Neaime, S. (2012). The global financial crisis, financial linkages and correlations in returns and volatilities in emerging MENA stock markets. *Emerging Markets Review*, 13(3), 268-282.

<sup>578</sup> Kroszner, R. S., Laeven, L., and Klingebiel, D. (2007). Banking crises, financial dependence, and growth. *Journal of Financial Economics*, 84 (1), 187-228.



Although now succeeded by the FCA, the FSA operated as a quasi-judicial body responsible for the regulation of the UK's financial industry from 2001 and 2013. It was an independent, non-governmental body that regulates the financial services industry in the UK, including most financial services markets, exchanges and firms. Granted statutory powers in the UK by The Financial Services and Markets Act 2000, the FSA sets standards to which such organisations must comply and can take action against them should they fail to meet required standards. The statutory roles for the FSA were to maintain market confidence, check financial crimes, and promote consumer protection and public awareness.

The FSA was also subject to political and public accountability, and must report on how well these objectives have been met annually, subject to scrutiny by parliamentary committees. Its objectives govern how the FSA carries out its general function of making rules, dispensing guidance and advice, and determining general policies and principles.<sup>579</sup> The FSA was also legally accountable, and must interpret its objectives correctly and consider them properly, or be liable to judicial review. Over time, new legislation emerged giving the FSA even broader powers. In 2000 for instance, the responsibility for Listing Authority from the London Stock Exchange (LSE) was also brought under FSMA and by law under the authority of the FSA.<sup>580</sup> These of course includes to the responsibility to act against market abuse. Extending the role of the FSA again in 2004 with an added role of dealing with issues relating to regulations on mortgage and insurance, which was an extension required to transpose the insurance mediation directive. Hence, the FSA became the major institution that deals with most financial institutions in the UK.

What also became obvious was how the enormous amount of responsibilities vested on the FSA to oversee most aspects of one of world's largest financial markets revealed some challenges and contingencies. This cumbersome task appeared to have contributed to the inability of the FSA to be effective in combating cases of market abuse happening in the system.<sup>581</sup> For example in March 2010, Hector Sants, then chief executive of the FSA agrees that market abuse in the UK has reached an "unacceptably

---

<sup>579</sup> Financial Services and Markets Act 2000

<sup>580</sup> Ibid.

<sup>581</sup> Burger, R. (2007). A principled front in the war against market abuse. *Journal of Financial Regulation and Compliance*, 15(3), 331-336.

high level", and therefore the need to come up more proactive measures to combat market manipulation and insider dealings was recognised.<sup>582</sup> This, however, was not a surprise in the sense that, the approach of the FSA then was to institute regulatory proceedings which may lead to fines and other sanctions leading ultimately to the withdrawal of authorisation.<sup>583</sup> The standard of proof in insider dealing was also a civil standard for regulation under section 118 of the FSMA, rather than criminal standards under the CJA 1993.

Revisiting the transition of what was later to become what is now known as the FCA, one also needs to look at the events that necessitated reforms in the financial regulatory system that began since 1985. Earlier, under the Financial Services Act 1986, the Securities and Investments Board Limited (SIB) was the board with the role of overseeing the market. The SIB continued as the body that was responsible for market regulations until the merger of banking supervision and investment services regulation, when the SIB was given a new name as the Financial Services Authority (FSA) in 1997.<sup>584</sup> This development saw the subsequent consolidation of its role and duties.

The FCA, which came into force in 2013 created a new regulatory framework for financial services and abolished the FSA. It is worthy to note that the establishment of FCA and PRA has systematically led to a decentralised system of regulation. A tripartite system has emerged that include the PRA, the FCA and the Financial Policy Committee (FPC).<sup>585</sup> The FPC is mainly a committee of the Court of the Bank of England charged with the responsibility for the protection of the stability of the financial system, or macro-prudential regulation.<sup>586</sup> In relation to market abuse however, the PRA and the FCA are the most relevant bodies. The PRA for example, is a subsidiary of the Bank of England that is shouldered with the role of ensuring that

---

<sup>582</sup> Burger, R. (2007). A principled front in the war against market abuse. *Journal of Financial Regulation and Compliance*, 15(3), 331-336.

<sup>583</sup> The types of Sanctions were contained in sections 205-209 of the FSMA. They include Censure, Penalty and Suspension.

<sup>584</sup> MacNeil, I. (1999). The Future for Financial Regulation: The Financial Services and Markets Bill. *The Modern Law Review*, 62(5), 725-743.

<sup>585</sup> *ibid*

<sup>586</sup> HM Treasury, 'A new approach to financial regulation: the Blueprint for reform' (2011) Cm 8083 p.282. See, [http://www.hm-treasury.gov.uk/consult\\_finger\\_blueprint.htm](http://www.hm-treasury.gov.uk/consult_finger_blueprint.htm) accessed 10th octobe2014.

risks in the financial system are checked by ensuring also the effectiveness of regulated companies.<sup>587</sup>

By law, the FCA is an independent regulator that has regulatory powers over many institutions, especially over market by regulating the conduct of insurance and investment companies, and those of agent and companies on banking to the extent that they are not subject to PRA regulations.<sup>588</sup> According to Baber the FCA also has a broader interventionist approach over the financial market than the previous regulatory regime under the FSA.<sup>589</sup> In discussing the need to have more robust and effective financial system regime in the UK as distinct from the Saudi regime calls for consideration of certain key elements one has to put into consideration. The first is that the UK market is more than ten times the size of the Saudi market in terms of both products and services. Therefore, the need for stricter and broader market regulations will naturally differ. The second element is that which has to do with the events of 2007 financial crisis that largely hit the bigger economies but has little impact in the economies of countries like Saudi whose economic base is largely dependent on oil extraction.<sup>590</sup> Hence, the events that influenced the need for more robust regulations, culminating in the establishment of FCA and other regulatory bodies did not exist in Saudi Arabia. Essentially, this suggests that the dynamics that prompt policy decisions across financial markets differ according to the existing and inherent trajectories of different regimes.

The FCA is a company limited by guarantee, tasked with the role of ensuring corporate governance of financial the market. The FSMA provides that the FCA has an obligation to uphold the principles of good corporate governance. The body constitutes of Board with members comprising: a Chair and a Chief Executive appointed by HM Treasury (Treasury); the Bank of England Deputy Governor for prudential regulation; two non-

---

<sup>587</sup> Grosse, R. (2012). Bank regulation, governance and the crisis: a behavioral finance view. *Journal of Financial Regulation and Compliance*, 20 (1), 4-25.

<sup>588</sup> Valitov, S. M., and Nigmatzyanov, A. A. (2014). Modern principles of financial services markets regulation as a response to the financial and economic crisis of 2008. *Mediterranean Journal of Social Sciences*, 5(24), 285

<sup>589</sup> Baber, G. (2013). A critical examination of the legislative response in banking and financial regulation to issues related to misconduct in the context of the crisis of 2007-2009. *Journal of Financial Crime*, 20 (2), 237-252.

<sup>590</sup> Turner, A. (2009). The Turner Review: A regulatory response to the global banking crisis (Vol. 7). London: Financial Services Authority.

executive members who are appointed jointly by the Secretary of State for Business, Innovation and Skills and the Treasury, and at least one other member appointed by the Treasury. The majority of the Board members are Non-Executive Directors (NEDs). The FSMA requires that the FCA to have a consistent measure that ensures accountability in the financial system including the need to report annually on the effort made in ensuring regulation of the market. Part of this includes the task of consulting consumers on the extent to which the activities of the FCA, including its policies has impacted on consumer and the market in general.

Through the Code of Conduct and the Corporate Responsibility Policy and the board, the FCA was charged with wider role and responsibilities that include ensuring transparency, integrity and to avoid insider trading and other forms of market abuse.<sup>591</sup> These are very important tasks that have to be met to ensure the safety of the market. Under the FCA's Disclosure and Transparency Rules for instance, issuers are required to provide formal notification to the market of any information that would be likely to have a significant effect on share price if used as a basis for investment decisions.<sup>592</sup> Apart from the need for disclosure being a universal standard in financial market, Moore and Walker-Arnott argue further that the UK corporate governance as a system imposes a great deal of priority to the disclosure practice, which the requirement for companies to keep “constant company-relevant data streams as a basis for stock allocation decisions and associated professional communications.”<sup>593</sup> All of these events suggest of strain associated with regulating one of world’s most largest financial industries.<sup>594</sup> A situation that is far from the Saudi which trades around 100million pounds daily.<sup>595</sup>

Market abuse is not only prohibited but is also triable by the FCA. The system is designed for a matter to be investigated by the FCA, which is then taken to the Regulatory Decisions Committee (RDC).<sup>596</sup> The RDC like the Saudi CRS, does not hear matter in public. However, if parties are dissatisfied with decision of the RDC,

<sup>591</sup> Authority, F. C. (2013). The FCA’s approach to advancing its objectives.

<sup>592</sup> DTR 2.2. See also, Moore, M. T., and Walker - Arnott, E. (2014). A Fresh Look at Stock Market Short-termism. *Journal of Law and Society*, 41(3), 416-445

<sup>593</sup> Moore, M. T., & Walker - Arnott, E. (2014). A Fresh Look at Stock Market Short - termism. *Journal of Law and Society*, 41(3), 416-445.

<sup>594</sup> See, <http://www.londonstockexchange.com/exchange/statistics/daily-trading/daily-trading.html>

<sup>595</sup> See, [http://www.tadawul.com.sa/Resources/Reports/DetailedDaily\\_en.html](http://www.tadawul.com.sa/Resources/Reports/DetailedDaily_en.html)

<sup>596</sup> See, <http://www.fca.org.uk/about/structure/committees#RegulatoryDecisionsCommittee>

they can take the matter to the Upper Tribunal, which re-hears case from scratch, in an open court. This is dissimilar to the system in Saudi where the parties do not have the right to appeal to any specified tribunal or court. This leads to the argument that, unlike Saudi, the system of proceeding in the UK gives the opportunity for a transparent hearing of a case where the parties are dissatisfied with the decision of the committee. It also reveals how the system in the UK has the potential of protecting the standards of process rights in litigation and appeal, which is underpinned by Article 6 of the ECHR that provides for the right to a fair trial. Another aspect that separates the Saudi system from the UK in terms of regulatory authority over institutions is that banks and insurance companies in Saudi are regulated by the Saudi Arabian Monetary Authority (SAMA), which is not related to the CML or the CMA. Investors in Saudi may ordinarily feel challenged when it comes to access to justice. Yet, the argument of regulators, as would be discussed in the subsequent chapter is that the system was designed in this manner to serve as a catalyst to investor confidence rather than a bottleneck.

The FCA is designed to be a self-standing body that regulates the conduct of business by all regulated firms, including those prudentially regulated by the PRA.<sup>597</sup> In the effort to tackle unethical behaviour in the market, one of the important powers of the FCA is the right to order for a prompt amendment or withdrawal of misleading marketing material.<sup>598</sup> Also, where the collective investment scheme which complies with the Undertakings for the Collective Investment in Transferable Securities (UCITS) directive is a unit trust, approval must be sought and obtained from the FCA prior to marketing the product to the public.<sup>599</sup> In general, the FSA was central to almost all aspects of within the financial market from the conduct of business among companies to aspects that relate to practices regarding efficiency, innovation, domestic and international character of markets, competition etc.

The goal of protecting the consumer and the market and to ensure effective competition in an ever-changing market, the UK has continued to introduce new policies that

---

<sup>597</sup> Ibid.

<sup>598</sup> Section 118 (5) of the FCA. Also see, Brandt, P. (2013). Changing of the guard. *International Financial Law Review*, 32, 41.

<sup>599</sup> Section 242 FSMA.

involved establishing new bodies. This is by far distinct from the Saudi financial market regime, which has seldom gone through any phenomenal reform since the Tadawul. By the introduction of the FSA 2012, the UK adopted a new provision that established the Financial Strategy Committee (FSC) and the Financial Policy Committee (FPC) of the Bank of England. The FPC is primarily tasked with responsibility in relation to the achievement by the Bank on identification, monitoring, and taking of action to remove or reduce, systemic risks with a view to protecting and enhancing the resilience of the UK financial system.<sup>600</sup> The PRA is also one other example of such bodies. It has the role of promoting the safety and soundness of firms, especially for insurers, to contribute to the securing of an appropriate degree of protection for policyholders, and to facilitate effective competition.<sup>601</sup>

#### 6.4 Conclusion

The development of the Saudi capital market was an attempt to diversify what is originally a mono-economy that is dependent on oil. What mainly began in 2001 was an effort by the Kingdom to develop an infrastructure for financial capital that would boost investment. The most important part of this was to establish a body capable of watching the market and ensuring transparency and ethical behaviour. This policy decision came through establishment of the Capital Market Authority (CMA) in 2003, which is probably the most important milestone in the drive to ensure a strong, sustainable and safe market for investors. Hence, the Saudi market was not only liberalised but also attracted a great deal of investor interest from both domestic and international investors. From the period the CMA took up, the market began to show signs of growth with number of listed companies increasing from 76 in 2001 to 139 in 2010. Investment has also increased exponentially from SAR 924.5 billion in 2008 to SAR 1.2 trillion in 2009.

Part of the initial regulatory proposals and actions that helped shaped the market include the abolishing of unregulated brokerage activities and introducing a standard

---

<sup>600</sup> Section 9 (c) FSA 2012. See also Tucker, P., Hall, S., and Pattani, A. (2013). Macro-prudential policy at the Bank of England. Bank of England Quarterly Bulletin, Q3. See also, <http://www.bankofengland.co.uk/financialstability/Pages/fpc/default.aspx>

<sup>601</sup> Ibid.

form of IPOs, which saw a great interest from investors. For instance, the market recorded unprecedented sales in the IPO of Saudi telecom in 2003, which saw an initial sale of over 2.7 billion dollars. Perhaps with some fluctuations, especially between 2004 and 2008, the capital raised through IPOs had continued to surge in the Saudi market. Part of the achievement of this diversification is that it became a protective edge for the Saudi economy. For example, while global economy was shrinking by up to 1.4 percent in 2009, the Saudi economy actually expanded by around 0.15 percent. Similarly, the IMF forecast the Saudi economy as one of the fastest growing in the gulf region. This had to some extent put the Kingdom in the league of potentially strongest economies in the gulf, other factors such as derivatives and credit products are seen as instruments that need to be further increased in the market.

In the long-term, there are obvious plans attributed to the optimism that the Kingdom has on diversifying its economy and the capital market. Especially with the fluctuating nature and uncertainty in the price of crude, the issue of diversification is now entering a new and most critical phase. There is more need to reduce the dependency on oil revenue and focus on financial and other investment opportunities. There is also an obvious rise in real estate investment across the GCC and the Saudi economy appears to show a great deal of interest in the real estate investment. But it is also important to note that, this research has identified the reluctance of the Saudi market to accept some of the trading ideas of western markets which are believed to lack the kind of transparency the Saudi does not, at least for now, seemed to be ready to compromise. We have seen for example the idea of OTCs and speculative trading that are inherent in the UK and which the Saudi financial market does not engage. To the CMA, the concept of buyers negotiating privately with limited knowledge of other crucial market variables offends the idea of transparency and is by far opposite of Islamic finance which still has relevance in the Saudi financial market. Admittedly, even the financial markets across Europe have identified that these kinds of trades pose some degree of risk on investors and have worked towards proposing reforms. Yet, it is observed that the reforms are still not as far-reaching because of the broad exemptions especially those involving commercial traders and position limits and indeed the failure to take pro-active measures on risks of failure as a result of the speculations common with large commercial traders that are often engaged in speculative derivative.

Like the Saudi, the UK's FCA an independent agency responsible for protecting investors, policing the markets and promoting competition. But beyond that, the UK also has the PRA, which is an arm of the Bank of England. The overriding objective of these bodies is to maintain confidence in the financial market and to ensure legality in trading and investment. Like the CML, the FCA also has powers to impose sentences i.e. fines on individuals or groups found in violation of market laws such as the intentional attempts in or succeeds in any manipulative or deceptive acts or practices in connection with any transactions in the market. Also prosecutable under this law is any direct or indirect, attempt to execute an order or execute a trade in a security for the purpose of creating a false or misleading impression of trading activity or interest in purchase. It is however important to note that unlike in the Saudi which has a simple definition of securities and restrictions, the broader definition of securities in the UK deflates the ability to have them fully regulated. Essentially, this broader contextualization of products and services, especially in bigger market such as the UK market is more complex, as much as it differs from what is needed to guide and govern emerging markets like Saudi. Hence, the various challenges faced by the UK financial market including the financial crisis of 2007 has had tremendous impact on how the regulatory bodies were restructured. The Saudi market however was not deeply affected and being at a formative stage, not much goes on with regards to reviewing market regulatory framework. The centre of regulation has therefore been the CMA which the UK has continuously split the various roles and have also continued to introduce new bodies.

## **Chapter Seven**

### **Enforcement and Penal Regime in the UK and Saudi**

#### **7.1 Introduction**

To ensure approved behaviour in the market, some degree of enforcement and penal mechanisms are necessary. These penal regimes are arguably the primary mechanisms that assure investors of the authority's readiness to safeguard against violations. It also ensures most of the theoretical underpinnings of creating a level playing field for all market participants and to reiterate the essence and consequence of fiduciary



responsibilities that includes the to act in good faith in the interests of beneficiaries and balance the conflicting interests of different beneficiaries and to also ensure prudence in terms of care and diligence in the discharge of duty.

But beyond these aspects that cover ordinary, companies and regulators, the existence of clear penalties for illegal behaviour also ensures that national and regional economies are safe from the danger of unscrupulous market conducts. The quest for a coherent enforcement and penal framework is therefore a necessary tool for the maintenance of a sustainable and investor friendly market atmosphere, which all markets aspire to achieve. Almost all the reforms seen in both the UK and Saudi were geared towards ensuring this level and safe playing field. Nonetheless, the structure of these enforcements and the nature of penalties differ, mainly due to the dynamics of the market as well as the distinct priorities and goals that different regimes pursue. It also include other realities such as the size of the markets, the expansive or narrow character of investment companies as well as the goals that define what the state aims to achieve both domestically and internationally.

This chapter intends to look at the nature of penal regimes in Saudi and the UK and how the enforcement of these penalties are designed and structured. Furthermore, the chapter would attempt to interrogate some of the differences between in the way two regimes and try to explain why these dissimilarities exist.

## **7.2 Structure of penal regime for market abuse in the United Kingdom**

Enforcing penalties for violations of market laws is a priority to regulatory agencies. In fact, they are one of the chief responsibilities of these institutions. The UK has gone through a number of far-reaching reforms over the years that includes the current FSMA regime, which spells out penalties for the offence of market abuse. These laws have both civil penalties that run parallel with the criminal responsibilities.<sup>602</sup> Some scholars maintained that the idea of having both civil and criminal penal regimes is because the previous regulatory regimes had proven ineffective in many respects, including inadequate enforcement because of regulatory fragmentation, and a heavy

---

<sup>602</sup> See, <http://www.fca.org.uk/firms/markets>.

reliance on criminal law sanctions in the punishment of market abuse.<sup>603</sup> Although, it has to be stated that in 2002 there were no criminal sanctions in the UK.

Although theories suggest the good and the bad of regulatory authorities, what is evident is the consensus that markets in contemporary intertwined financial world need more regulations and watchdogs than any time in history. The establishment of a measure such as the MAD is a further confirmation that market abuses are becoming sophisticated, borderless and complex and therefore the need to have multijurisdictional and dynamic approach on how to deal with them. Recent incidents have also revealed how economies around the world are so interrelated that the effect of one would go a long way in affecting others. These legal regimes are therefore crucial in safeguarding not only municipal or regional market integrity and transparency, but also the safety of the global economy

While the CJA 1993 criminalises insider dealing, section 118 of FSMA deals with any of the seven types of behaviour mentioned earlier, and provided only regulatory penalties.<sup>604</sup> Other aspects described in the UK laws which has similarities with the Saudi legislations include the offences of misleading statement and engaging in a deceptive manner of action for the intention of incite others to exercise or desist from exercising rights in relation to investments. These are offences under Sec 397 FSMA that has now been replaced by Sec 89-91 of the FSA 2012. The major difference between the two jurisdictions however is that, while the UK has different laws that govern aspects of the market, the Saudi financial market laws deal with both civil and criminal aspects through the same legislation i.e. the CML and of course through the same bodies the CRSD.

### **7.2.1 Nature of criminal sanction for market abuse in the United Kingdom**

Insider trading has been a criminal offence in the UK for over 30 years. The Companies Act 1980 and the Companies Securities (Insider Dealing) Act 1985 originally

---

<sup>603</sup> Pistor, K., and Xu, C. (2002). Law enforcement under incomplete law: Theory and evidence from financial market regulation. LSE STICERD Research Paper No. TE442.

<sup>604</sup> Part V of the UK's Criminal Justice Act 1993.

proscribed insider dealing in the financial markets.<sup>605</sup> Apart from insider dealing, these Acts also sanction other types of financial market abuses. But the nature and effect of these offences require that the enforcement of penalty also take into account a way of dealing with some in a civil process. Hence, these obvious gaps of the old regime paved way for the FSMA, which introduced a new civil regime to market abuse, identifying three forms of behaviour under section 118 FSMA i.e., those relating to misusing information, misleading the market and distorting the market.<sup>606</sup>

The FSMA 2000 is one of the most significant legislations made regarding UK's financial market. It brought in some important reforms that allows for regulators to deal with market abuse through other forms of regulatory penalties, instead of the previous approach of strict criminal law sanctions.<sup>607</sup> Although the exercise of powers under section 123 of FSMA 2000, the FCA can impose a penalty or make a public statement or take disciplinary actions as laid down under section 205. They may also take other regulatory actions such as 'restitution order', asking the offenders to surrender their ill-gotten gains to those injured by their violation, provided that the offence has some specific victims that can be identified.<sup>608</sup> The idea of restitution is one form of penalty that is common with most regimes including Saudi.

While section 52 of CJA 1993 spells out criminal sanctions for insider dealing it is important to note that corporations are excluded from this provision.<sup>609</sup> Hence, it relates primarily to individuals found guilty of insider dealing, and can be convicted under the provisions of the CJA.<sup>610</sup> In the prosecution of individuals, the law also makes clear certain conditions that must be met. Essentially, it states that the person must be in possession of such insider information and must have used it to either trade in securities on a regulated market, or if it is an OTC transaction through a professional intermediary

---

<sup>605</sup> Thapa, R. (2010). Insider Trading: A Brief Overview of Legal Regime in USA, UK, India and Nepal Mirmire-Economic Article Special Issue, Vol. 38, No. 293. Available at SSRN: <http://ssrn.com/abstract=1599212>.

<sup>606</sup> Abrams, C. (2000). Financial Services and Markets Act: market abuse. *Amicus Curiae*, 2000 (32), 22-24.

<sup>607</sup> Avgouleas, E. (2005). *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*. Oxford University Press.

<sup>608</sup> Section 384 FSMA 2000.

<sup>609</sup> Part V of CJA 1993 came into force on 1 March 1994; Part V restated the UK's law on insider dealing was also brought it into line with the EC Insider Dealing Directive.

<sup>610</sup> Hannigan, B. (1994). *Insider Dealing*. London: Longman, 2nd edn.

i.e., lawyers and accountants, or must himself be a professional intermediary, or .<sup>611</sup> The person may also be liable if he or she encourages another to deal in securities relating to insider information. Avgouleas however argues that, being that criminal regime for insider dealing is based on Part V of CJA 1993 its operation also resulted in overlap and asymmetry between the criminal and administrative regimes, creating ample scope for confusion both in terms of market players' compliance and in the context of regulatory enforcement.<sup>612</sup>

On misleading statement and dishonest concealment, which are a breaches attracting penalty as provided under Sec 89-92 of the FSAct 2012, there is a requirement that the statement, promise, or forecast was made dishonestly. The test of dishonesty was clearly laid down where the Court of Appeal held that the test for dishonesty is that which is defined by reference to the ordinary standards of reasonable and honest people.<sup>613</sup> Regarding the way by which to measure what may constitute recklessness, it was in case law developed under section 13 of the Prevention of Fraud Act 1958, which was later repealed and replaced by FSAct 1986 and the FSMA 2000. Earlier views on this aspect of the market were echoed by the likes of Paull J., who termed 'recklessness' should be used within its ordinary meaning in English, i.e., 'a rash statement or promise made heedless of whether the person making it has any real facts on which to base it'.<sup>614</sup> This position was also supported by the Court of Appeal.<sup>615</sup>

The sanction for misleading statement, dishonest concealment under section S 89-91 of the FSAct 2012 includes summary convictions and other sanctions contained in Sec 92 of the FSAct 2012 which states that on conviction on indictment, the offender may go for a prison term not exceeding 7 years or a fine, or both.<sup>616</sup> There is however an exception to this that may exonerate the accused. Despite the fact that some observers believe the regulatory bodies should pursue more criminal sanctions as a form of deterrence,<sup>617</sup> there are certain rules of criminal procedure in the UK that make such

---

<sup>611</sup> Section 59 of the CJA 1993 defines professional intermediaries to include brokers and market makers i.e., those involved in acquisition and disposal of securities.

<sup>612</sup> Avgouleas, E. (2005). *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*. Oxford University Press.

<sup>613</sup> *R v Gosh* [1982] QB 1053.

<sup>614</sup> *R v Grunwald* [1963] 1 QB 935.

<sup>615</sup> *R v Page* [1996] Crim LR 821.

<sup>616</sup> Section 92 FSAct 2012.

<sup>617</sup> Musikali, L. M. (2009). Why Criminal Sanctions Still Matter in Corporate Governance. *International Company and Commercial Law Review*, 20(4), 133-141.

prosecutions less appealing than civil litigation. For example, to convict a corporate body, the prosecution must establish not only the act but also the state of the mind of the company's agent (as companies can be vicariously liable for the act of its employee). This rule has come to be identified as the 'directing mind' doctrine. These are not situation that is not common with the Saudi market, where the regulators are still perceived as the principal bodies with the primary role of monitoring the companies and its agents. The concept of fiduciary duty is central to financial market regulations. Another aspect of the penal regime in the UK is that it is still possible for people punished for manipulation under Sec 89-91 of the FSAct 2012 or for insider dealing under Part V of CJA 1993 to be held liable the common law for the offence of conspiracy to defraud. Although this may not be always be the case as exemplified in the case of *Tom Hayes* in relation to the manipulation of then LIBOR benchmark, where the jury found other defendants not guilty of conspiracy to defraud.<sup>618</sup>

As much as price sensitivity is central in issues surrounding insider trading, it may sometimes be difficult to measure this element. How this is conceptualised according to Avgouleas is that the information regarded as insider information must be information, which may affect an issuer's business prospects, and if published, would have an impact on the market price of the issuer's securities. It is not enough when the information only contains aspects that relates to securities and their issuers in general and abstract terms.<sup>619</sup>

However, like stated there is the complexity of overlap of criminal and civil sanctions. A clear example is Sec 89-91 of the FSAct 2012, which sets out the offence of making misleading statements, while the courts have successively ruled on the criminality of these acts. This offence carries many characteristics that it makes the distinction between civil and criminal very narrow. Even a simple definition of misleading statement can be multifaceted. It could mean a situation where an individual makes a false or deceptive forecast. Similarly, the law finds it as an offence where an individual

---

<sup>618</sup> *R v Hayes* [2015] EWCA Crim 1944. Commenting on the case, Director of the SFO David Green said, "The key issue in this trial was whether these defendants were party to a dishonest agreement with Tom Hayes. By their verdicts the jury have said that they could not be sure that this was the case. Nobody could sensibly suggest that these charges should not have been brought and considered by a jury." See, <https://www.sfo.gov.uk/2016/01/29/libor-defendants-acquitted-update/>

<sup>619</sup> Avgouleas, E. (2005). *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*. Oxford University Press. See also Section 60 (4) CJA 1993.

dishonestly makes reckless deceptive promise or forecast, or where an act was done recklessly and causes harm on another person.

Again, taking into in to context the same provision of Sec 89-90 of the FSAct 2012, clearly describes what constitutes misleading statements as statements, promises or forecasts that are misleading, false or deceptive. The provision went on to say that the person become culpable if they make the statement, promise or forecast or conceals the facts for the purpose of inducing, or is reckless as to whether it may induce, another person, whether or not the person to whom the statement, promise or forecast is made.<sup>620</sup> A close look at the sections reveals that apart from deliberately concealing information or giving a wrong one, the only occasion that would result in criminal liability is when the information given is wrong and done in a reckless manner. Now the technicalities lead to issues surrounding ‘wrong information given recklessly’. Again, even where a criminal action becomes not feasible due to insufficient grounds, the civil penalties may still be imposed.<sup>621</sup> This expansive and complex legal provision is absent in the Saudi regime. In Saudi, where such events occur, the CRSD may decide as it deem fit to issue a warning or suspend the licence of the company for such period it deem necessary. Even though the reference here is in the context of acts in market abuse, they also have legal precedents in criminal law.

But looking at past developments, one may argue that the distinction on the burden of proof for criminal and civil cases for market offences was narrow. For example, in the case of *Engels*,<sup>622</sup> a three part test was set out to determine whether proceedings are civil or criminal in nature. In the case of *Davidson*, it was held that “penalties for civil market abuse were, at least for the purposes of Article 6 of the European Convention on Human Rights, criminal in nature.”<sup>623</sup> However, it is now clear that the FSMT in *Davidson* were wrong and the matter is correctly stated by the Upper Tribunal where it held that in civil procedure, the civil standards of balance of probability applies.<sup>624</sup> The consequence was that whilst the burden of proof might still be the civil/balance of

---

<sup>620</sup> Ibid.

<sup>621</sup> See for example the case of shell, where they refused responsibility but still paid fine.

<sup>622</sup> *Engels v Netherlands*, ECHR 3, 5100/71 [1976] 1 EHRR 647.

<sup>623</sup> *Davidson and Tatham v Financial Services Authority* [2006] UKFSM FSM031

<sup>624</sup> *Hannam v FCA* [2014] UKUT 0233. See also, see also *FCA v Da Vinci Investments*[2015] EWHC 2401.

probabilities, it had to be applied in a way which was consistent with the seriousness of the matters to be proved.” Hence, the question regarding burden of proof in criminal and civil litigation for market abuse cases is a topic that is generating new debate.

What is evident in general penal regime in the UK is that regulators have often avoided criminal litigation for obvious reasons. One of the primary reasons is that procedural aspects relating to criminal litigation in the UK comes with all the conventional aspects of criminal trial including the burden of proof required for establishing criminal liability.<sup>625</sup> These high standards placed for the proof of criminal act has made the FCA reluctant many times to pursue criminal trial. Hence, civil litigations often become the most preferred form of enforcement of penalties. Another important aspect is that where parties cooperate with the regulators, there is the likelihood that the FCA will resort to fines in civil action and refuse to pursue any criminal action. Records however show that as of March 2016, the FCA has secured 27 convictions for insider trading.<sup>626</sup> Moreover, parts of the FSMA also raised certain concerns about the compatibility of these enforcement provisions with the ECHR. A recent example is the ECtHR decision in the case of *Grande Stevens and others v Italy*,<sup>627</sup> which raised the debate on the concepts of a right to a fair trial and the double jeopardy rule. Prior to this judgement, it is accepted that where both administrative and criminal enforcement proceedings were available for the same conduct, both could be pursued. They have also been left often to national legislatures or courts. But by this new precedent, the ECtHR states that, where both criminal sanctions and sanctions formally classified as "administrative" are applied, the latter will not necessarily be immune from challenge under Article 4 of the Protocol. These are among the concerns that raise the question on whether the FSA's disciplinary and enforcement powers were compatible with the general principles and specific provisions of the ECtHR. The reason for this concern is because of the far reaching implication of the decision of the ECtHR and Article 4 of Protocol No. 7, which state that no one shall be liable to be tried or punished again in criminal proceedings under the jurisdiction of the same member state for an offence for which a person had already been acquitted or convicted in accordance with the laws of that

---

<sup>625</sup> See for example the case of Kenneth George Carver FCA final Notice, 30<sup>th</sup> March 2015. See, <https://www.fca.org.uk/your-fca/documents/final-notice/2015/kenneth-george-carver>.

<sup>626</sup> For a list of convictions, See, <http://fca.org.uk/news/former-equities-trader-pleads-guilty-to-insider-dealing>

<sup>627</sup> *Grande Stevens and Others v Italy* (application nos 18640/10, 18647/10, 18663/10 and 18698/10)

state. The court in *Grande Stevens* found a violation of Article 4 notwithstanding the fact that only one of the proceedings in the case before them was recognized in Italy as "criminal" in nature.<sup>628</sup>

The criminal offences that includes manufacturing deceptive information or engaging in a path of misleading behaviour and insider dealing carries punishment of a maximum of seven years' incarceration or an unlimited fine as penalty. The penal regime for civil offences on other hand emphasizes on higher monetary penalties to be imposed. The regulatory authority can compel a financial penalty or make a public statement about the behaviour. An example of the weight of civil penalty was clearly demonstrated when the UK imposed a record £6.1million for an offence of market abuse after revealing a scheme to manipulate the share price of India's branch of Reliance Industries on the London Stock Exchange".<sup>629</sup> In addition, the regulatory authority could also submit an application for an injunction restraining market abuse or an order for compensation.<sup>630</sup>

### **7.2.2 Nature of civil responsibility in the UK**

While the general proposition for criminal cases, including those in financial market is based on the principle of proof beyond reasonable doubt, the civil proceedings maintain the proposition of the 'balance of probability'. The way in which the FSA would use enforcement powers and, in particular, how it imposes civil fines has initially raised enormous concerns. For example, the promulgation of the Code of Market Conduct COMAC was marked by a great deal of controversy that led to the drafting of detailed rules to counter some of the criticism.<sup>631</sup> This is another characteristic of a market that is as large as the UK, as opposed to market such as Saudi. The FCA has to provide a

---

<sup>628</sup> Ibid.

<sup>629</sup> FCA issued the fine for failing to act with due skill, care and diligence in the period leading up to the illegal manipulation of the closing price of securities traded on London Stock Exchange by Rameshkumar Goenka, The full report was contained in the FCA document available at <https://www.fca.org.uk/your-fca/documents/final-notice/2011/fsa-final-notice-2011-rameshkumar-satyanarayan-goenka>.

<sup>630</sup> Ibid.

<sup>631</sup> Avgouleas, E. (2005). *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*. Oxford University Press.



voluminous rulebook, which also created a complex web of overlapping regulatory rules whose construction often requires enormous expert advice.<sup>632</sup>

What is evident, however, is that in numerous instances, the FCA has enforced penalties accruing to millions of pounds on parties found guilty of market abuse. Despite the fact that this may look somewhat like success in dealing with offenders, some critics argue that the regulatory focus on risk-based approach to enforcement is not enough deterrence as violators may commit such acts again, owing to the fact that they suffer less criminal penalty. But as stated earlier, there is a reason why the regulators pursue the civil route. It is easier. Unlike the provisions of section 397 FSMA now contained in Sections 89-91 FSAct 2012, the requirement to support a civil litigation for market abuse for example under the MAD does not require that the offence was committed knowingly or recklessly, it suffices if the offence was established. This includes many aspects of the market violations from tipping off, to dissemination of information likely to affecting transaction rather than for legitimate reasons etc.

Although the MAD was meant to ensure a common standard of market behaviour across EU member states, it was also found to be lacking in some way triggering several reviews such as the MAD II. As Gottlieb (2014) argues, MAD was perceived to have a number of shortcomings, which were highlighted following the onset of the financial crisis in 2008. MAD II is intended to address these shortcomings by (i) broadening the scope of the market abuse rules to capture new markets, especially the spot commodities markets and multilateral trading facilities and updating the market abuse regime to reflect developments such as high frequency trading (ii) harmonizing the application of market abuse rules, exemptions and sanctions across the EU; and (iii) strengthening administrative sanctions for market abuse and introducing criminal sanctions.<sup>633</sup>

Another important characteristic worthy of note is the presence of some quasi-judicial remedies that the FSA may use pre-emptively to avert market abuse or its continuation.

---

<sup>632</sup> Ferran, E., and Goodhart, C. (Eds.). (2001). *Regulating Financial Services and Markets in the 21st Century*. Bloomsbury Publishing. The writers referred to FSA policy statement where it was observed that the FSA's development of overlapping regimes has left many loose ends, which could spell damaging uncertainty to firms and individuals alike if not tied up one way or another.

<sup>633</sup> Gootlieb, C. (2014) MAD II Adopted by European Parliament and Council. *Alert Memorandum*

This includes injunction, which the FSA may request from a High Court to prevent a company from committing or continuing an act that amounts to market abuse.<sup>634</sup> In August 2015 for example, penalties were under Sec 381 of the FSMA 2000 concerning a type of market manipulation known as '*layering*' or '*spoofing*' of the stock market, which is essentially to create an artificial small price movements and take advantage of it.<sup>635</sup> This type of action against companies may occur when an investigation reveals that the company's behaviour may amount to market abuse and if the court is satisfied, there is reasonable ground to suggest that market abuse is likely, and then the injunction would be granted. This type of injunction is also available when the need arises to prevent a person from disposing assets he acquired through acts deemed as market abuse.<sup>636</sup> This according to Avgouleas, is done to remedy the effects of the relevant abusive behaviour.<sup>637</sup> Again, there is a disparity here with what is applicable in Saudi, being that to obtain these injunctions, regulators have to approach a regular court. In Saudi Arabia, however, these powers are still centralised and are within the prerogative of the regulatory bodies.

Another distinct features in the UK, which are in contrast with regulations and enforcement under the Saudi laws is that they also apply to certain behaviours beyond companies that trade in securities, the regime also applies to other kinds of trades. For example, the largest fine to date in respect of market abuse was the fine against Shell for overstating the volume of its oil reserve.<sup>638</sup> The logic of the FSA then was that the shares of Shell Corporation are traded on the floor of the LSE and therefore, overstating their reserve is clearly a case of misleading investors and therefore amounts to market abuse. Although this may be treated from a different legal perspective if in Saudi, the idea of it being dealt with by the FSA is not out of place since the value of the oil company is closely related its reserve.

---

<sup>634</sup> Section 381 (1) FSMA 2000.

<sup>635</sup> FCA v Da Vinci Invest Limited and Others [2015] EWHC 2401 (Ch)

<sup>636</sup> Section 381 (3) and (4) FSMA 2000.

<sup>637</sup> Avgouleas, E. (2005). *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*. Oxford University Press. See also Section 381(2) and (6) FSMA.

<sup>638</sup> FSA document available at [http://www.fsa.gov.uk/pubs/final/shell\\_24aug04.pdf](http://www.fsa.gov.uk/pubs/final/shell_24aug04.pdf). The result was a fine of £17m (which Shell paid without any admission of liability). The FSA stated that were it not for Shell's co-operation with the FSA and its efforts in addressing corporate governance and accounting issues (effectively 'systems and controls' improvements despite the fact that Shell was not an FSA-authorised firm), the penalty would have been substantially higher.

### 7.3 Challenges of market size in the UK

In discussing the nature and character of enforcements, law reforms and penal policies in the financial markets, one also has to understand the challenges and constraints that emanate with the increasing size and scale of such market. Unlike Saudi, the UK financial industry has over a million employees, and accounts for approximately 7 percent of the country's GDP. Moreover, it has over 1,000,000 trades daily<sup>639</sup> every day. Hence, its vulnerability to abuse, an especially insider dealing is an aspect that is always challenging to regulators.<sup>640</sup> Compare this with the Saudi Capital Market that has approximately 400 professional staff to supervise approximately 150 listed companies and 84 authorised persons.<sup>641</sup> Hence, it would be fair to say that the two markets are proportionately not at par in terms of trading and capital and therefore the character of regulation and the structure of enforcement would differ profoundly. These realities suggest that cases of insider dealing are likely to occur many times, and not all would be successfully uncovered. Despite the fact that identifying and enforcing penalties could be challenging due the variety of constraints, scholars suggest that it still easier when dealing with market abuse in the context of corporate and accounts or revenue announcement than it is for the day-to-day trades and transaction that happen in the market.<sup>642</sup>

For example, unlike Saudi, in the UK, civil and criminal litigations for offences of market abuse are dealt with in different ways and under different laws. Perhaps one set of facts or behaviour in the UK can amount to both a criminal and civil responsibility, the choice of either pursuing both civil and criminal route or deciding on only civil case often depends on the circumstances of the case as well as the choice of authorities. Some observers also maintain that, public pressure and cooperation of the guilty party with the authorities have effect on how these cases are prosecuted.

---

<sup>639</sup> See, <http://www.londonstockexchange.com/exchange/statistics/daily-trading/daily-trading.html>

<sup>640</sup> Leitch, A. Criminalising market abuse - the shifting sands of enforcement by the FSA April 2007 - Litigation & Dispute Resolution. Legal Developments by SJ Berwin LLP. Available at <http://www.legal500.com/developments/2955>.

<sup>641</sup> Amico, A. (2014), "Corporate Governance Enforcement in the Middle East and North Africa: Evidence and Priorities", OECD Corporate Governance Working Papers, No. 15, OECD Publishing.

<sup>642</sup> Leitch, A. Criminalising market abuse - the shifting sands of enforcement by the FSA April 2007 - Litigation & Dispute Resolution. Legal Developments by SJ Berwin LLP. See, <http://www.legal500.com/developments/2955>.

#### 7.4 Regional legislation on enforcement

Unlike Saudi, penal enforcements for market abuse which has not gone through any far reaching change, the UK is a different story. For example, amendments in 2012 have brought in additional rules that criminalises manipulation of benchmarks including LIBOR and EURIBOR (IP/12/846). The UK has criminalised this behaviour under Sec 91 FSAct 2012. It is important to state here that, the MAD is the current EU-wide framework for tackling both insider dealing and market Manipulation since 2003. But with adoption of in April 2014, of a new Market Abuse Regulation (MAR) and a new Directive on criminal sanctions MAD 2 (also known as the Criminal Sanctions for Market Abuse Directive or CSMAD). MAR and MAD 2 will become applicable for most purposes from July 2016. But in this situation, it must be emphasised that the UK has a special position under the Lisbon Treaty as regards EU criminal law measures and is not bound by them unless it chooses to opt in. From what The Chancellor of the Exchequer stated in 2014, it appears the UK would not opt in to MAD 2.<sup>643</sup> The Vice president of the commission stated:

Investors who trade on insider information and manipulate markets by spreading false or misleading information can currently avoid sanctions by taking advantage of differences in law between the 28 EU Member States. Some countries' authorities lack effective sanctioning powers while in others criminal sanctions are not available for certain insider dealing and market manipulation offences. Effective sanctions can have a strong deterrent effect and reinforce the integrity of the EU's financial markets.<sup>644</sup>

Complementing a further proposal endorsed by the commission in 2013 (MEMO/13/774), the directive referred to the powers under the Lisbon Treaty, calling on members to enforce criminal sanctions for cases of market abuse, including the incitement, aiding or abetting such offences.<sup>645</sup> These resolutions were targeted towards increasing the convergence of national legislations and improve certainty over existing penalties for abuse of commodities and related derivative as well as over-the-

---

<sup>643</sup> See,

<http://www.freshfields.com/uploadedFiles/SiteWide/Knowledge/MAR%20fact%20sheet%20241014.pdf>.

<sup>644</sup> Ibid.

<sup>645</sup> See, [http://europa.eu/rapid/press-release MEMO-14-77 en.htm?locale=en](http://europa.eu/rapid/press-release_MEMO-14-77_en.htm?locale=en).

counter (OTC) transactions.<sup>646</sup> Moreover, any behaviour, which manipulates the calculation of a benchmark, or those that amount to misleading inputs, will be considered market abuse irrespective of intent or negligence.

In the regional market situation, some observers argue that there are few insights into the full magnitude of market abuse across an expansive territory such as the EU, but it is estimated that investors were disadvantaged approximately 8.5 billion Euros as of 2013.<sup>647</sup> The UK being one of the largest markets has a fair share of these incidents. For example, the FCA publishes statistics on ‘market cleanliness’ in 2014 where it indicates some abnormal movements in the market in days preceding major takeover *bids*, which is an indication of insider dealing. However, records also suggest that these types of incident or movements in the market have gone down from 21.2 percent in 2010 to about 14.9 percent in 2012.<sup>648</sup>

But as some scholars argue, the implementation of the EC Market Abuse Directive in the UK was a difficult issue because of relative asymmetry of the market abuse regime, the UKLA’s Listing Rules and the Directive’s definitions of what constitutes market manipulation and insider dealing.<sup>649</sup> Yet, it is evident that the dual approach that led the amendment of Parts 6 and 8 of the FSMA i.e., Issuer Disclosure Rules and Market Abuse has succeeded in remodelling of the offence of market abuse under section 118 of the Act.<sup>650</sup> Hence, the FSA introduced in a new sourcebook the Disclosure Rules (DR) and effected a number changes to COMAC, including the endorsement of the EC Regulation on Share Buy-backs and Stabilisations.<sup>651</sup> The advantage of this remodelling, according to Avgouleas is that the UK market abuse regime has become more comprehensive.<sup>652</sup>

---

<sup>646</sup> See, <https://blogs.cfainstitute.org/marketintegrity/2014/03/18/market-abuse-in-europe-harsher-penalties-for-insider-trading-market-manipulation/>

<sup>647</sup> See, <https://blogs.cfainstitute.org/marketintegrity/2014/03/18/market-abuse-in-europe-harsher-penalties-for-insider-trading-market-manipulation/>

<sup>648</sup> Ibid.

<sup>649</sup> Avgouleas, E. (2005). *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*. Oxford University Press.

<sup>650</sup> FSMA2000 (Market Abuse) Regulations 2005, SI 2005/381.

<sup>651</sup> Regulations (EC) of 22 December 2003 implementing Directive 2003/6/EC on exemptions for buy-back programmes and stabilization of financial instruments

<sup>652</sup> Avgouleas, E. (2005). *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*. Oxford University Press.

Another important aspect that distinguishes the Saudi and UK financial market is on how laws are constantly reviewed or developed. In the sense, the UK financial industry have continued to see reviews in its legislation while in Saudi, these reviews rarely occur. Yet, it is evident that with the size of its market and the legislations coming out of the EU, the industry is bound by these kinds of situations. Referring to the need for these kinds of reforms, Martin Wheatley, former head of the FCA says, the changes were aimed at embedding “personal accountability in the culture of financial services and are a crucial step in rebuilding public trust”.<sup>653</sup> It is however important to note recent developments e.g., section 32(2) of the Financial Services (Banking Reform) Act 2013 that has now been amended by Section 25 of the Bank of England and Financial Services Act 2016 reverses the presumption of responsibility as originally enacted. In the sense that section 25 now provides that no senior manager will be guilty of misconduct unless the FCA or the PRA, as applicable, can prove that the senior manager did not take reasonable steps to avoid the breach occurring or continuing.<sup>654</sup> This suggests that the UK is backtracking to some extent on personal accountability, especially when it comes to the question of evidential burden.

Another thing the rules were intended for according to FCA is “to address the inherent differences between incoming branches and UK relevant firms, while minimising the potential for arbitrage across UK relevant firms and incoming branches, which can pose similar conduct risks to the UK market.”<sup>655</sup> Relating these to the Saudi regime, one can safely argue that the Saudi regime may not go through this kind of reforms as it does not have different bank branches spread across many countries in the world, except a few in the gulf states. Therefore, even if such reforms are to be proposed, they may not be overarching.

## 7.5 Framework of penal enforcement under the Saudi Arabia financial market regime

The legislative framework for financial market for both domestic and foreign companies listed in the Saudi capital market are subject to the general provisions of the

---

<sup>653</sup> See, <https://www.fca.org.uk/news/fca-publishes-rules-on-how-it-will-apply-the-new-accountability-regime>

<sup>654</sup> See, <https://www.lexology.com/library/detail.aspx?g=912d96de-9493-434f-8a89-ba0cc701cff0>

<sup>655</sup> Avgouleas, E. (2005). *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*. Oxford University Press.

Listing Rules, including those on continuing obligations, brokerage and rules on mergers and acquisition. For the purpose of breach of any regulations, including market abuse, the procedure in Saudi requires that the CMA refer the matter to the Committee for the CRSD. One of the distinctive features of the Saudi enforcement regime is that all powers, including those for criminal violations are vested in the CRSD as opposed to the UK where such cases are triable by regular criminal courts. Although this administrative overture over criminal litigation may appear to be contrary to the traditional principles of criminal justice, the idea behind this, according to findings is to give assurance to all investors, especially foreign investors that their matters would not be tried in regular Saudi courts which are guided strictly by Shari'ah laws.<sup>656</sup>

Moreover, being that conventional courts in Saudi are Shari'ah courts and the judges are mainly trained in the application and procedure of the Shari'ah legal system, there is an obvious challenge over how they can be given the jurisdiction to deal with disputes between people or companies that do not necessarily succumb to all the provisions of the Shari'ah. Even if that is easy to achieve as the trades and indeed the offence could be said to have been committed in Saudi, it still not a good structural incentive to attract foreign investment. Hence, the authorities came up with a framework puts the entire jurisdiction of financial market disputes and offences in a single institution with the expertise over these issues and with knowledge of international best practices.<sup>657</sup> Another rationale is to reassure investors that these disputes would be settled by an institution with expertise in investment disputes as against judges of courts that are mainly trained in Shari'ah law and procedure.

The CMA and the CRSD work to ensure that market conducts are in line with Saudi laws while taking into account the need to maintain international best practices.<sup>658</sup> Hence, the general rules pertaining to trading of securities must be done without committing what may constitute manipulation and insider trading among other violations. There are clear sanctions and penalties for violations of any part of the law and its implementing regulations. The regulatory regime in Saudi has over the years

---

<sup>656</sup> Beach, J. W. (2005). Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets. *The. Stan. J. Int'l L.*, 41, 307.

<sup>657</sup> Marar, A. D. (2004). Saudi Arabia: The Duality of the Legal System and the Challenge of Adapting Law to Market Economies. *Arab Law Quarterly*, 19(1), 91-124.

<sup>658</sup> Nick, T., and Hanna, C. (2010). *An Introduction to the Principal Stock Exchanges of the UAE, Saudi Arabia, Kuwait and Bahrain*. Gibson Dunn publications

seen steady improvement in guarding the market against violations and in issuing sanctions. For example, a recent report by the IMF lauds the Saudi regulatory agencies for their successes in supervision and enforcement credentials, including issuing implementing regulations.<sup>659</sup>

This effort to guard the market is the principal reason for the Royal Decree No. M/30 of July 2003 that established the CML. The idea behind the sixty seven articles in the decree was to have a financial market regulation regime that would monitor, investigate and penalise acts of market abuse,<sup>660</sup> as well as sanctions for the operation of the Saudi Arabian securities exchange.<sup>661</sup> It is however important to state that even with these laws and monitoring policies Saudi Arabia had had its own fair share of market abuse cases. Hence, some critics have questioned the level of enforcement, especially the nature of penalties that are seen as insufficient and ineffective, perhaps due to the recurring allegations of market abuse.<sup>662</sup> These kinds of criticisms however cut across both smaller and larger financial regimes across the world including the UK. What research shows is that, market abuse, particularly insider trading is a secretive endeavour that some may likely go unnoticed.<sup>663</sup>

In a move similar to reform measures seen in the UK, the CMA in 2007 went further to introduce a new trading platform to deal with the market manipulation problem. The platform allows for detailed operation tracking, which was claimed to have rooted out over 400 cases of suspected illegal use of insider information, as well as closing down 186 websites for the offence of dissemination of false rumours.<sup>664</sup> The first penalty for insider dealing did not come until August 2009.<sup>665</sup> This heralded the beginning of any sort of sanction to be enforced by the CMA. Observers also see this as an effort to

---

<sup>659</sup> IMF(2012). Saudi Arabia: Reports on the Observance of Standards and Codes. See, <http://www.imf.org/external/pubs/ft/scr/2012/cr1293.pdf> IMF Country Report No. 12/93

<sup>660</sup> Royal Decree No. M/30, Articles 49 and 50.

<sup>661</sup> Ibid, Article 50-67.

<sup>662</sup> Ibid.

<sup>663</sup> Bris, A. (2005). Do insider trading laws work? *European Financial Management*, 11(3), 267-312.

<sup>664</sup> Ibid.

<sup>665</sup> In the said case, The chairman of the board of Bishah Agricultural Development company, Najm-Eddine Ahmad Najm-Eddine Dhafer was sentenced to three months of imprisonment with a fine of US\$ 26.6 thousand, and additional payment of US\$ 14 thousand because of gains obtained through insider trading with the company's shares. Dhafer was found guilty of insider trading in Bishah shares based on him being the chairman of the company's board. He is the first individual in Saudi Arabia convicted for the unlawful use of insider information. His conviction echoes the Saudi effort to depict better dependability on its capital market, which is characterized by large retail investor participants



reaffirm the Kingdom's commitment to market transparency and a level playing field that will further appeal to investors and give them confidence both within and outside the kingdom.

### **7.5.1 Causes of action in Saudi Arabia**

There are, according to the CML, four causes of action that can be brought by investors. The first, which is quite similar to the UK, is the ability to sue for recovery for misrepresentation in the prospectus. Where there is a false statement or omission of material fact, showing that it affected price at which the investor would have purchased the security, then such an investor has a legitimate case.<sup>666</sup> In cases of these falsehood or misleading conducts, the CML focuses mainly on subjective standard of proving that the act actually affected the price the investor would have been willing to pay.<sup>667</sup> Although this is well within comparison with the UK, the CML has a clause, which states that, despite a prospectus not certified by an expert, the issuer may not be liable if he or she shows that they have reason to believe, and actually believed that there was no material omission or misstatement. But it has to demonstrate that after reasonable investigation, and on the basis of reasonable grounds he was convinced such part of the prospectus was not a violation of any part of the law.<sup>668</sup>

Moreover, the law states for an action to be successfully prosecuted, the omission must occur on a prospectus that was approved by the authority.<sup>669</sup> The paradox here is that which overlooks the significance of an expert in certifying a prospectus. This raises the question on the vulnerability of such prospectus to avoidable mistakes. Although the CML allows that, pending approval, the issuer may review and correct any misleading information that still does not take the place of an expert opinion. Another aspect is that the law exonerates any certifying expert from liability where he or she is able to show that he conducted reasonable investigation and has grounds to believe there was no material omission.<sup>670</sup> The standard of measuring reasonable diligence according to the provisions of the CML is that it "shall be of the prudent man in the management of his

---

<sup>666</sup> Beach, J. W. (2005). Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets, *The. Stan. J. Int'l L.*, 41, 307.

<sup>667</sup> Ibid.

<sup>668</sup> Article 55 (c) (1) CML.

<sup>669</sup> Article 55 (a) CML.

<sup>670</sup> Ibid.

property.”<sup>671</sup> Another form of action is one that can be brought against unlicensed brokers. Any contract or other agreement related to any transaction restricted to licensed brokers that are entered into by an unlicensed broker is unenforceable. The unlicensed broker has no right to recover any money or property transferred under the contract. The other parties involved in the transaction, however, may recover any money or property transferred, so long as it also returns any money or property it received. The CRSD has sole jurisdiction over all suits on this matter.<sup>672</sup>

As part of enforcing anti-fraud provisions, the CML also makes false statement in connection with another’s sale or purchase a violation. Again, for such violation to be actionable, it must be shown to be done out of negligence or recklessness.<sup>673</sup> The other situation is to do with the general provisions under Article 49 that deals with market manipulation. Where a person can prove that he was adversely affected by the conduct of another person who deliberately interfered with the fair operation of the market and create misleading appearances with respect to the price market or commodity. In all of the mentioned circumstances, the cause of action is the same, and investors have the right to be indemnified.<sup>674</sup>

The system of measuring indemnity or compensation is of a different character in Saudi. Where the committee decides that a victim of market manipulation is to be compensated, the damages would often be the difference between the prices actually paid for the security and its value at the date of bringing the action or the price for which the security could have been sold on the Tadawul before filing the complaint with the CRSD.<sup>675</sup> This is quite similar to the principles of civil liability in the UK. In the absence of a prior agreement to indemnify among the defendants, the CRSD decides what indemnity is equitable. Another significant character of the procedure in Saudi is that where a person decides to avoid any proceedings before the CRSD, he is still liable to pay compensation by agreeing to pay the CMA a sum up to three times the profits derived from insider trading.<sup>676</sup> The CRSD also has the powers to issue a prison sentence for market manipulation or insider trading, that only comes with the request

---

<sup>671</sup> Article 55 (d) CML.

<sup>672</sup> Beach, J. W. (2005). Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets, *The. Stan. J. Int'l L.*, 41, 307.

<sup>673</sup> Ibid.

<sup>674</sup> Article 56 CML.

<sup>675</sup> See articles 55 (e), 56 (b) and 57 (b) CML.

<sup>676</sup> Article 64 CML.

from the CMA. Where the offender is to serve jail term, the length of imprisonment should not to exceed five years.<sup>677</sup>

Similar to what is evident in the UK, the character of the Saudi system appears to be more centred on the civil approach to enforcement of penalties. But the fact that a person can be sentenced to jail by a committee and not a regular court brings in unique criminal justice process that many will question. Any criticism of this system therefore has some legitimacy, especially because even appeal from the CRSD can only be heard by the CRSD's appeal panel which is also not an open court or tribunal.<sup>678</sup> Therefore, any investor who suffers damage in their investment can only bring an action before the judicial bodies designated by the CMA, meaning that no conventional court in the kingdom has jurisdiction over these kinds of disputes.<sup>679</sup> The same rule applies to disputes on securities between market participants. While the approach to enforcement and penalty for breach in Saudi market could be relatively lenient compared to the UK, especially that the Saudi regime does not appear to pursue both civil and criminal case over the same case, the regulatory agencies are no less concerned about market abuse than their counterparts in the UK. The 2006 Gulf stock crash has furthered the activity of these regulators to enforce penalties and make the market more attractive again.<sup>680</sup>

### **7.5.2. Procedure for investigation and trial in Saudi**

The manner in which this action begins is via a complaint by the victim, which shall be investigated by the authority, and a case would be opened against the company before the CRSD.<sup>681</sup> Where the committee establishes that an offence had been committed that involves either market abuse or any violation of the provisions of the CML or those contained in the Tadawul, the committee has powers to preside and to penalise. The CML further provides that, where such complained is filed to the Authorities by an investor, such investor has to wait for ninety days for the bureaucratic procedure to be concluded; after which he or she is informed that he can file his case to the CRSD.<sup>682</sup>

---

<sup>677</sup> Article 49-50 CML.

<sup>678</sup> Article 25 CML.

<sup>679</sup> Alanazi, B. M. G. A. (2012). Investor protection and the civil liability for defective disclosures in the Saudi securities market: a legal analysis.

<sup>680</sup> Amico, A. (2014), "Corporate Governance Enforcement in the Middle East and North Africa: Evidence and Priorities", *OECD Corporate Governance Working Papers*, No. 15.

<sup>681</sup> Article 25 CML.

<sup>682</sup> Article 25-26 CML

Moreover, no case tried by the CRSD can be appealed before conventional courts. As Gouda pointed out:

“This means once the case has reached the Appeal Panel from the CRSD, it has exhausted all the available remedies under the Kingdom’s system. At this point, the case becomes, more or less, akin to a *res judicata* case in the common law system. The CML also contains antifraud provisions that bar fraud, manipulation, omissions and misrepresentations in connection with the sale and offering of securities.”<sup>683</sup>

The general procedure is that once a case is before the CRSD, evidence can be obtained without warrant.<sup>684</sup> Some scholars however question this process of obtaining evidence to be contrary to the civil rights granted to criminal suspects under section 3-4 of the Criminal procedure law of 24/08/1422H.<sup>685</sup> However, one also has to admit that the CRSD is not a regular court. Moreover, the nature of penalty awarded for offences of market abuse are mainly in form monetary penalty and does not necessarily have the characteristics of a criminal litigation. Hence, even if scholars argue that the system of acquiring and tendering evidence violates the general standards of criminal laws of the kingdom, proponents claim that this system has proven efficacious over the years and a number of cases have been successfully prosecuted in this manner by the CRSD.

Civil penalties are generally drawn in a way that there has to be clear evidence to suggest that there is actual harm to an investor. In the case of criminal sanction however, what is required is to establish that the act was committed, not necessarily that an investor suffered any loss. On the timing for action, the Saudi regime has a clear provision, which requires that actions for violations must be instituted within a year from the moment the complainant knew about the situation and not more than five years from the time the violation took place as provided under Article 58 of the CML.

---

<sup>683</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The Ann. Surv. International and Comp. L.*, 18, 115.

<sup>684</sup> Ibid.

<sup>685</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The Ann. Surv. International and Comp. L.*, 18, 115.

### 7.5.3 Nature of penalty in Saudi

The nature of penalty to be imposed for cases of market abuse depends largely on the nature of the abuse. This is governed under Article 49 of the CML, which can be in form of restriction on the buying or selling of the security. The CML also makes explicit provisions on restricting persons who obtain insider information from family members or any other mutual party from trading directly or through another person in the security. The CRSD may order that the offender indemnify, or order an issuer to pay the gains derived from the violation into the CMA's account. Under the CML, any individual responsible for market manipulation is liable to pay damages to any person adversely affected by act.<sup>686</sup> Penalties could also include barring the offender from acting as a broker, portfolio manager or investment adviser for the period of time that is necessary for the safety of the market and the protection of investors or bar the offender from working with companies whose securities are traded on the Tadawul.<sup>687</sup> This may be added to any monetary penalty that may be enforced by the committee. Article 56 of the Saudi CML states clearly that “any individual who creates, or is responsible for another making, orally or in writing an untrue statement of material fact or omits to state that material fact, if it causes another person to be misled in relation to the sale or the purchase of a security, shall be liable for compensation of the damages”.<sup>688</sup> The accused will be individually and jointly liable for damages by persons who purchase or sell the security in question whose price has been considerably unfavourably affected by such manipulation for the amount such persons are so affected.

In the case of misleading or false content in the prospectus, senior officers, underwriters and issuers bear the liability.<sup>689</sup> In the event of this kind of situation, the CMA referees the case to the CRSD. Depending on the gravity of the act, in the event the issuer was alleged to be attempting to commit such wrong, the committee may go ahead and take measures to avert the violation and issue a warning. But where the act had already been committed, the committee often orders the issuer to indemnify those that suffer loss and

---

<sup>686</sup> Article 57 CML

<sup>687</sup> Al Kahtani, F. S. (2013). The Saudi External Institutional Framework for Corporate Governance.

<sup>688</sup> Article 56 CML

<sup>689</sup> Article 55(b) CML

all proceeds of such violation are seized from the issuer. In other situations, the committee may order the suspension of trading in the said security.<sup>690</sup>

Despite the similarity between the UK and Saudi regime on regulators' powers to ensure penalties for violations of securities and exchange rules, some scholars maintain that the Saudi enforcement authorities are less specific.<sup>691</sup> In essence, the Saudi enforcement laws allow authorities wider discretion in terms of shifting the detail to the implementing rule.<sup>692</sup> The powers granted to authorities under the CML suggests that they can penalize persons engaging or engaged in violation through numerous kinds of penalties that are often based on discretionary overture.<sup>693</sup> They range from seizure to restitution orders to censure. The effect of this is the lack of certainty for companies on what the penalty would be in the event of a particular kind of violation.<sup>694</sup> The law however allows for some form of negotiated settlement with the payment of specific fine range as discussed earlier. Where the violation requires that fine should be paid to the state, the offender is to pay fine of up to three times his gains or avoided losses.<sup>695</sup> This agreement is strictly between the CMA and the offender in form of a negotiated settlement. When this is achieved, then the CMA cannot forward the matter to the CRSD.<sup>696</sup>

Moreover, regulators also have powers to revoke permanently a broker's licence. Another penalty that is specifically described is the jurisdiction of the CRSD to enforce fines on any broker without a licence to the tune of 100, 000 Saudi Riyals and could also give an additional sentence of up to nine months prison term, depending on the circumstances of the violation.<sup>697</sup> But an important aspect worthy of note is the right of the offender to file an appeal with the Appeal Panel of the CRSD to review any

---

<sup>690</sup> Alanazi, B. M. G. A. (2012). Investor protection and the civil liability for defective disclosures in the Saudi securities market: a legal analysis.

<sup>691</sup> Beach, J. W. (2005). Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets, *The. Stan. J. Int'l L.*, 41, 307.

<sup>692</sup> Ibid.

<sup>693</sup> Article 59 CML

<sup>694</sup> Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The. Ann. Surv. Int'l & Comp. L.*, 18, 115.

<sup>695</sup> Article 64-67 CML

<sup>696</sup> Ibid.

<sup>697</sup> Article 59 (b) CML.

decision of the CRSD.<sup>698</sup>

## 7.6 Conclusion

From the evidence in this study, it is clear that both Saudi and the UK authorities are more inclined to pursuing the civil route which gives more assurance of imposing penalty and indemnifying the victim than criminal litigations which are cumbersome. One of the reasons for making the civil regime more prominent, especially in the UK is the argument that turning every market offence into a criminal action is capable of resulting in enormous court cases and is unlikely to serve the general interest of the market or the investor. Another problem is that criminal matters had to be tried according to the general procedural standards laid down aspects of criminal justice where proof beyond reasonable doubt is a supreme principle. This process is therefore not only difficult; it is also cumbersome for cases involving market abuse. It is also a judicial procedure that prioritizes punishment more than compensation. Hence, the emergence of civil regime is seen as a move that increased the effectiveness of enforcement of penalties through compensation for victims through various mechanisms that allow investors to seek civil redress for their losses. Yet, it is also important to note that some critics vehemently oppose the idea of giving civil redress more priority, arguing that it is not an effective deterrence measure. But it must also be admitted that to the ordinary investor, recovering his loss is often more important than jailing an offender. But despite the apathy for criminal litigation in both regimes, not in all cases are regulators hesitant to pursue criminal sanctions. Cases involving misleading statement are mainly dealt with through criminal litigations, especially in the UK. This indeed is because, the offence of misleading statement is not so difficult to ascertain compared to other forms of market abuse. They are often successfully investigated and the facts disclosed in clear terms. This also lead to the question of why misleading statements do occur, which some scholars like Berwin believe that in very competitive markets like the UK, companies are often under pressure to deliver results that are close or equal to market expectations, which may compel companies to shape

---

<sup>698</sup> Article 60 CML.

the interpretation of an accounting policy.<sup>699</sup> He further pointed to evidence that suggest only a few professionals in the financial markets consider what they do in the course of the professional work as is tantamount to market abuse. These common attributes of financial markets have in many ways resulted in altering certain parts of the of the disclosure or even be subject to or susceptible to different interpretations since accounting standards and policies are written documents. Perhaps, this difficulty is exacerbated by the fact that accounts are derived in part by the adoption of various accounting standards and policies, which is also what applies to market announcements about interim/on-going financial and performance. It is important to note that these demands and competitions are more common with world's larger financial markets such as the UK and are not frequent in markets such as Saudi Arabia.

In general, the character of penal regimes and the way of imposing sanctions are designed in what is deemed as best legal practices as much as what suits the different priorities of the different financial market regimes. This is clearly demonstrated in the fact that while the UK has different bodies to try civil and criminal offences, Saudi has centralised these roles in the CMA and CRSD, essentially avoiding regular courts, which are based on Shari'ah laws. What is synonymous with both Saudi and the UK is that, the regulation regarding enforcement of penalties in cases relating to dealings or attempts to deal in qualifying investment or related market instrument base on insider information is a breach of both the laws in Saudi, UK and beyond. While in certain situations, an offence and loss had to be established; in other instances even an attempt to commit such act is punishable. But like all other liabilities, the penalty for financial market violations differ based on the regulations applicable according to regimes and subject to the nature of the violations. Quite similar to what is applicable in Saudi, even an attempt to commit such offence qualifies as a violation in the UK. There is also a similarity with some of the exceptional rules. One of those is that which disallows the authorities in both regimes to impose a penalty where it is shown the alleged offender has reasonable grounds to believe his or her actions did not constitute market abuse, or where they took reasonable precautions through due diligence to avoid behaving in a way which constituted market abuse.

---

<sup>699</sup> Leitch, A. Criminalising market abuse - the shifting sands of enforcement by the FSA April 2007 - Litigation & Dispute Resolution. Legal Developments by SJ Berwin LLP. See, <http://www.legal500.com/developments/2955> Accessed on 23/04/2015.



One important characteristic is that the Saudi regime has a limit to the extent of prison term to be imposed no matter what the offence is. This can be safely equated to the reality that these criminal sanctions are not imposed by courts but by administrative bodies. This indeed is a clear departure from the system in the UK. Moreover, the Saudi regime has made specific legal limitations on the amount of fine not be paid in the event of violations. Although this may sound restrictive, what is clear is that the financial market in Saudi is still one that is in a phase of development when compared to the UK financial market. Moreover, the laws in Saudi have not seen far-reaching changes and reforms. Yet, like other financial markets, especially those in the advanced world, reforms and law reviews are phenomenon that the Saudi regime had to deal with as its financial markets keeps expanding.

## **Chapter Eight**

### **General conclusion**

#### **8.1 General conclusion and recommendation**

At the beginning of this study, it is shown that the last six decades have seen a major turning point in the structure of global financial market, with the proliferation of different kinds of products and services as well as new approach to regulation of market activities. Evidence shows that financial markets around the world have continuously become more interconnected through international trade and investment. This has increased growth but also increased competition and risk. Globalisation of the financial market, like other aspects of economics has made the system more sophisticated, driven by both large investment and new technology for the execution of trade and dealing in different types of commodities across continents. As the traditional barriers of trade and investment continue to shrink, they come with a new challenge on the complexity of these trades and the potential for market abuse.

The study also shows that, the expansion of trade and the opportunities it presents has motivated countries, including those that rely on particular commodities for their national income to begin the process of diversification in the financial industry. Saudi Arabia is one of those countries that began an ambitious stride towards building a financial market that would serve domestic consumers and also attract international investment. However, it is shown in this study that legal culture and socio religious values of Saudi Arabia has restricted its ambition to introduce all sorts of financial products and services found in other countries, particularly in western markets such as the UK. This resistance was due mainly to the desire to preserve distinctive Shari'ah principles regarding finances and market transactions. Yet, the study also shows the willingness of the Saudi financial market to draw closer toward standardization based on global corporate governance.

The questions raised here are in relation to the convergence and the areas of divergence between Saudi financial market system and the one in the UK, and on how Islamic financial principles akin to Saudi can be compatible to the wider framework of financial market practices across the world, especially the western hemisphere. This challenging

but significant question has brought to the fore the position of some writers, who opined that the development seen in modern Islamic financial system represents a revival and re-adaptation of Shari'ah principles along a broad spectrum of cultures and polities, and a potential bridge across gaps that have historically divided the Muslim world from western civilizations. It is shown how the field of legal pluralism, and the cross-fertilization of different legal traditions, both Western and non-Western have also affected the way financial markets are evolving in Saudi.

It is predominantly evident that the financial market industry in Saudi, the UK and many other regimes across the world has become a vehicle for allocating capital and also risk. Their operations have also become so interconnected that efficiency often lies in transnational corporation and transparency. This is an aspect that was discussed in this study from a comparative pluralistic context that shows neither of the two markets operate in absolute isolation. The most important area of contention and divergence is the debate on the perspective of Islamic economics, which has historically emphasised on developing interest-free and profit and loss-sharing models. This idea is deeply embedded in the notion of 'form over substance', which is rooted deeply in Islamic philosophy, and has contributed greatly to the kind of resistance to complex structured financial products and services similar to those in the UK and other western markets. Hence, the questions of compatibility and regulations become relevant to this research.

In chapter three of this study, a detailed discussion was made on the different kinds of traditional Islamic financial instrument and how some were made to replicate modern financial products while keeping their substantive characteristics in line with customs (*Urf*) of Islamic finances. This transformation was shown in this study to affect different products including what is now known as a bond contract in the Saudi financial market. It is however important to note that, despite this transformation, the concept of *Urf* has remained relevant in all aspects of financial market development in Saudi emphasizing on the divine principality fairness and moral responsibility. Another important aspect of this discussion is the principality of the concept of public interest, which is a major factor both in trade and in market legislations under Islam law. Hence, speculations and interest based trades are seen as out rightly forbidden; a sticking point in every debate on market between the west and the Islamic world.

In this chapter, the research was able to expatiate on the nature, the character, the contentions and the distinction between the major forms of contracts that are traditionally known to Islam and those that have historically remained relevant in Saudi Arabia. The significance of this discussion is in relation to how they are similar to some products found in the UK and beyond. The main traditional market products are contracts such as *Mudarabah*, which is a trust, based financing agreement akin to Western-style limited partnership. Closely related to *Mudarabah* is *Musharaka*, which is a joint venture, whereby two parties i.e. the lender and the client contribute the capital for a business or project.<sup>700</sup> The capital is managed by both parties and profits shared based on pre-agreed ratios. Although there are similarities between *Mudarabah* and *Musharaka*, this study found out that there are some obvious differences, because in *Musharaka* the capital comes from all the partners, while in *Mudarabah*, it comes only from one of the parties.

*Murabaha* is a contract where the lender pays for a tangible asset at the request of a customer and sells the property to the customer on a deferred sale basis with a mark-up reflecting the institution's profit. While this contract is common and generally regarded as permissible, there are a number of legal issues under Shari'ah, which include the prohibition of excessive profit; a situation that may occur in *Murabaha*. Another contract discussed in this chapter is *Ijarah*, which is mainly a hire contract that engages the services of persons. *Ijarah* is one of the oldest forms of Islamic contract and its permissibility is contained in different provisions of the Holy Qur'an and Sunnah. The permissibility of *Ijarah* is contained in the Qur'an and Sunnah.<sup>701</sup> It represents both an employment contract, as rental of real property. This contract also falls under the category of what is termed in the UK as lease. However, it is important to note that despite its permissibility under Islam, this research also found that there are areas of unresolved issues among Islamic jurist. They contend that features of modern *Ijarah* in Saudi leaves areas that need to be clarified because it has evolved to become both a debt and an equity. In one way, it is similar to an asset-backed loan, and on the other, it has the features of an equity because the nature of estimation process of expected salvage value can be positive or negative. It is essential to state here that, the traditional

---

<sup>700</sup> Ismayil, S. I. (2012). *The Principles of Islamic Finance, Its Challenges and Policy Suggestions for Azerbaijan* (Doctoral dissertation, Eastern Mediterranean University (EMU)).

<sup>701</sup> Yusuf Ali Qur'an English translation 8: 77; 28: 26 and 65: 65-66.

concept of *Ijarah* is clearly permissible, but as this type of contract begins to take new dimensions, they present areas of research that become open to new debate.

Other products include *Istisna*, which is a pre-delivery financing and leasing used mainly to finance long-term capital-intensive projects. While this kind of contract is similar to *Murabaha*, this research shows a distinction between the two. The main difference is that in *Istisna* contract, certain expenses that are not reflected in a sale and purchase agreement may be included in the fees payable to the financial institution by the lessor company.

Another type of contract that is traditionally not common to Islamic finances but that which is now common is Takaful. With a contemporary model developed in Sudan in the late 1970s, it has since become part of financial service in Saudi Arabia. This type of contract entails the payment of instalments into a fund where the banks act as managing trustee. It was argued in this study that the idea of insurance has continuously raises controversy under the Shari'ah. Proponents however argue that unlike the type of insurance policies in the UK and other countries, Takaful is simply a mutual insurance where participants are regarded as the owners of the fund, reserved to salvage any of them who suffer loss or damage. The main argument against Takaful, as seen in this study, is in relation to the prohibition of *gharar* (uncertainty), since the benefits to be paid depends solely on the outcome of future unpredictable events. Others argue that Takaful closely resembles gambling. Evidently, life insurance cannot easily be regarded under Islamic principles as a kind of insurance in which a person benefits if they suffer loss or damage. Hence, this study argues that it does not fall under the category of contracts permissible under Shari'ah. Further arguments in relation to this type of contract is the possibility of Banks as trustees, reinvesting the premium monies in products which are unacceptable in Islam. Yet, other scholars including, Prof. Mustafa Al-Zarqa, concludes that all types of insurance are permitted under Shari'ah.<sup>702</sup> While he agrees that insurance has elements of *gharar*, he states that it is insignificant to the degree that it can be overlooked. However, this study concludes that, even if other

---

<sup>702</sup> Adil Salihi Permissibility of Life Insurance Arab News, 02/09/2004. See, <http://www.aljazeera.info/Islam/Islamic%20subjects/2004%20subjects/February/Permissibility%20of%20Life%20Insurance,%20Adil%20Salahi.htm>.

forms of insurance are acceptable as form of mutual insurance, life insurance cannot stand the test of permissibility under Shari'ah.

This research has also put forth discussion on the oldest form of financing in Islam known as *Qard Hasan*, which is based on lending without any form of interest or conditions other than the repayment of the original loan. This is a type of contract that is not common in western institutions, but still exists in Saudi Arabia through government supported facilities. It is a contract that is highly recommended by Shari'ah with its roots in the principle of compassion for those in dire need and a way for institutions or governments to promote growth by divulging money into the society to support failing trades and businesses. Other forms of finances are *Al salam* contract which is like the modern day bond regime as in the UK, but with the condition that any investment in those bonds must be specifically invested in Shari'ah compliant products that do not have elements of usury, speculation or *gharar*. In its literal sense, *Al-salam* refers to future sale, which has its root in earlier times when farmers in the Islamic world receive cash advances pending harvest. In modern times, this research found that the idea has transformed to include contracts where a seller undertakes to supply a specific commodity to the buyer at a future time and the buyer advances payment for the price of the goods. Another form of bond that is common is the *Ijarah* bond, which is more like a leasing agreement. But unlike conventional lease in the UK, *Ijarah* is not permitted for contracts where there are uncertainties. Islamic scholars have emphasized that since *Ijarah* are for future periods, then it is to be considered as a bond and to be covered by certificates. Discussing the types of Islamic finances and their characteristics, it is evident that unlike the UK, financial markets in Saudi Arabia were largely conceptualised based on the kinds of trades and investment allowed under the Shari'ah.

This study goes on to show the most significant development in the Saudi capital market was the opening of the Saudi stock exchange i.e., the Tadawul. As of 2015, it has listed 169 publicly traded companies, a development that heralds a major liberalisation of capital market and the introduction of new innovative products to complement some of the products found in major capital markets around the world. Yet, it was shown in this study that in Saudi Arabia, a complete financial market system

with its identifiable instruments and markets is still at an early stage of evolution and still coping with numerous challenges relating to regulations and instruments. The necessity to regulate the market stems from the fact that trades and investment are risky as much as they are beneficial and theories have shown how for markets to be safe to all participants there must be some degree of responsibility and role to be played by both market participants and authorities.

In discussing the theoretical framework of this study in chapter four, the discourse looks at the various scholarly arguments about market activities. The study looks at the philosophical, moral, religious and economic arguments on market abuse and how it relates to both participants and regulators. Theoretically, this research first explores the major distinguishing factor between Islamic and secular western philosophies in the context of separating what is regarded as the sacred from profane. The general consensus under Shari'ah literature is that all forms of manipulation or abuse of market is prohibited. But unlike the Islamic position, this research found that some Western scholars are of the opinion that not all acts of market abuse are wrong. For example, there is the theoretical argument that insider trading is an elements that increase efficiency in the market. Yet, overwhelming evidence suggests that this notion in support of insider trading is not the prevailing opinion among most scholars. Also, in regulatory and legislative circles, all forms of market abuse have consistently been considered as criminal.

Another important discourse is the paradox regarding the argument of 'victimless crimes', which consider some form of market abuse as acts without a definite category of people who can be considered as victims. However, the position of this research is more of the notion that when information was used secretly or illegally to benefit one group in the market, may likely have unfair effect on the other group. That is what market manipulation and insider trading does. This is also the position of the 'fair playing field' theorists who argued, any transaction of buying and selling is unethical when the information is asymmetric. This however does not automatically makes the market as level as scholars wish. In the real sense, the information is always asymmetric as some have more information than others. What is important is that such information not be used for personal benefit against the interest of others.

Another theoretical argument discussed is the theory of fiduciary duty, which places responsibility upon managers and other custodians of the interest of investors to treat such as trust. Despite the strength of this theory, critics opined that the responsibility is mainly placed upon officers and employees who sometimes have no fiduciary duty to shareholders. It is, however, important to further stress that the principle of this responsibility is not in the hierarchy or class of individuals in an organization but in ensuring that any person whose employment or professional status gives them access to sensitive information, then should not be used for personal gain or to assist others to gain from it at the expense at other market participants. Against the background of these debates, scholars have also argued about the fairness principle, which emphasises that morality and ethics of dealing in market transactions. It insists that for a market to be fair, all participants must have fair access to the market information and should be able to understand the kind of risk and reward that the contract presents.

The theory of fairness and fiduciary responsibility is what underscores most religious argument regarding market transaction. Islam for example has clear commands in the Qur'an and the Hadith on fairness and sincerity in all dealings. It also prohibits greed including excessive profiteering, while mandating transparency and ruling against usury and *gharar*. This is a clear departure from western secular market economy which makes abuse illegitimate but allows for usury and contract that involve some degree of uncertainty. In terms of regulating the market, this research concludes that both western and Islamic systems have encouraged on the state interfering to ensure the safety, stability, accountability and transparency.

Discussing market abuse from an Islamic context, it is a phenomenon well known and discussed in Islamic economics. The idea of fiduciary responsibility for examples is closely associated with the principle of Amanah and *Fiqh al Muamalat* (The doctrine of honesty in all human dealings); that he who holds other people's wealth or has access to their investment must also exercise utmost honesty; not to cheat or defraud or to act against their interest. This dominant narrative of regulation and responsibility is the hallmark of rules on financial market in Saudi Arabia. Also, unlike in some western philosophies, the question of insider trading and market manipulation is not contentious under Shari'ah. The consensus all through history is that Islam prohibits any transaction



in which parties use certain hidden information or processes that were deliberately hidden from others to make profit for themselves.

The majority of these philosophies supports the need to regulate the market in order to ensure fairness. To a larger degree, these debates have shaped how legislation has emerged in various systems across the world including Saudi Arabia and the UK. In the effort to make the financial market securer and more effective, legislative frameworks have continued to emerge, giving way to regulatory institutions. This happens alongside the proliferation of new products and services into the financial market.

In chapter five of this study, it was shown that in Saudi Arabia, the development of a financial market has necessitated the enactment of several laws and the establishment of institutions to adequately monitor the market against abuse and insider dealings. This development is similar to what was seen in the UK decades ago and that which still continues in the constant reviews of laws to deal with new developments in the financial market. What this reveals is that, the more a financial market of any country becomes open to different kinds of products and services the more the need for legislative review to protect the market from illegal practices.

This study has also shown that both the UK and the KSA have commonalities in terms of their approach to deal with financial abuses and boosting investor confidence. But their approach differs in some ways. As shown in this study, there are reasons for this disparity, which include the economic history of the two regimes. For example, it is shown that the UK is among the largest financial capitals of the world for a very long time, the KSA has traditionally been an economy that is reliant on energy export. Hence, the UK, unlike Saudi, has for long been saturated with all kinds of financial products and services that the need for regulation and review of law has always been present. This has resulted in different bodies been put in place alongside enormous amount of legislations that have seen some overarching reviews repeal and re-enactments. Despite this difference in the character of the financial market, this study has shown areas of convergence between the two regimes, especially in terms of the contents of laws when it comes to market manipulation and insider trading. However, this research also reveals the difference in the way these financial offences are penalised.

Looking mainly at recent legislation i.e., the CML in Saudi and the FSMA in the UK, an area of divergence is that the Saudi regime deals with almost all aspects of financial market, civil and criminal through a single piece of legislation the CML, while UK has other laws such as the FSMA and the CJA. The UK financial market regime is also affected by other legislations such as EU's regional legislations (MAD). It is shown that the CML is a phenomenal legislative development for financial market regulation in the Saudi Arabia. It serves as a consolidation of other laws e.g., a Saudi Law against Deception in Trade of 1984,<sup>703</sup> and the advertisement regulations law of 1992,<sup>704</sup> and the Competition Law of 2004.<sup>705</sup> It also incorporates provisions of the Corporate Governance Regulations 2006,<sup>706</sup> Listing Rules 2006,<sup>707</sup> Securities Business Regulations 2006,<sup>708</sup> and a host of other laws discussed in the chapter. But even with the promulgation of the CML, one thing that remains contentious is that, unlike in the UK, the CML has no standard definition of 'securities'. The provision of Article 2(e), CML, which refers to securities, does not give the kind of clarity as was given under the FSMA. Therefore the exemption is mainly an exemption in transaction not an exemption in securities that are readily sold in the market. Interestingly, this research also found that despite the lack of clear definition of securities, the law now allows their issuance. Perhaps they were restricted to joint companies until the 2008 amendment to the CML, which subsequently allows the issuance of both private and public securities.<sup>709</sup>

The major areas under the CML, especially those to do with market abuse are quite close to international standards under IOSCO. Both laws prohibit any act or omission that creates misleading impression as to the prices or the value of any commodity for the purpose of creating that false impression or inducing other market participants to subscribe for security or to refrain from doing so. Both legal regimes also consider it an offence to engage in insider trading. Both the CML and the FSMA prohibit using any

---

<sup>703</sup> Royal Decree No. M/11, 29/05/1404H (Jan. 3, 1984).

<sup>704</sup> Royal Decree No. M/35, 28/12/1412H (June 28, 1992).

<sup>705</sup> Competition Law, Royal Decree No. M/25, 4/5/1425H (June 22, 2004).

<sup>706</sup> No. 1-212-2006, 21/10/1427AH (Dec. 11, 2006).

<sup>707</sup> CMA Board Resolution, No. 2-128-2006, (Jan. 22, 2006).

<sup>708</sup> No. 2-83-2005, 21/05/1426H (June 28, 2005).

<sup>709</sup> Article 6-7, Offers of Securities Regulation.

information obtained by the insider and which is not available to the general public, or has not been disclosed.<sup>710</sup> The CJA 1993 also criminalises insider trading.

It is also found that both legal regimes make it mandatory for companies to disclose all relevant information regarding products and services to the public. It is a law for instance to ensure that companies do not omit any important information from the prospectus. Any such omission that results in damage to any investor is actionable. It is however important to state that the way these complaints are brought and resolved differ between the two regimes, an aspect that was covered comprehensively in chapters five and six of this study. For example, all disputes or criminal allegations in the Saudi market can only be brought to the CRSD and its appeal panel, which are bodies established by the CML and directly under the CMA. No civil or criminal court in Saudi Arabia has jurisdiction to entertain financial market disputes, whether it is market manipulation or insider dealings. This is a clear departure from the approach in the UK where the RDC and the Upper tribunal can listen to a matter and also conventional courts have powers to entertain, especially cases of insider dealing as criminal offences, perhaps through adversarial proceedings under the rules of the CJA.

Another important aspect of the CML is that where foreign laws are violated by persons carrying out business within Saudi Arabia, and the CMA is notified formally of such violation by a foreign regulatory institution, then the CMA may suspend the license of such company involves the suspension of the license of such violators for twelve months.<sup>711</sup> But for such suspension to take place, the CMA must be notified formally of the violation by the foreign regulator.<sup>712</sup> This provision further restates Saudi Arabia's commitment to cooperate and work together with other institutions across the globe, a sign of internationalisation and cooperation.

This research also found that unlike in Saudi Arabia, legislations in the UK deals with market offences in two ways. In the sense that, insider dealing which has been an offence defined under the CJA 1993 is dealt with within the framework of this law as a criminal matter before a criminal court, civil matters on the other hand are subject to

---

<sup>710</sup> CMA (2011). Manipulation and insider trading.

<sup>711</sup> Article 62(a)(4) CML.

<sup>712</sup> Ibid

the provisions of the FSMA. The major challenge which the UK faces in dealing with financial offences in conventional courts, especially those that involve criminal allegations is that the standard of proof is that which is required for every other criminal offence. Hence, it comes with enormous task of proof and evidence. Furthermore, is that the CJA does not involve civil aspects of compensation, which is seen as lack of sufficient protection for the investor's interest for their loss to be made good. This is clearly distinct from what is applicable in Saudi Arabia where both civil and criminal aspects of the market are dealt with by the CRSD, and compensations readily offered in both situations. Another important aspect that distinguishes the UK and the KSA is the presence and influence of other external rules on domestic laws. The UK for example is also affected by EU legislation on European markets. Principally, what constitute market abuse, has close similarities in both jurisdictions, the major difference is found in the way these laws are enforced.

Another important issue raised is that regarding the statute of limitation under the CML which mandates that a case must be brought within five years of commission. This provision is seen to be problematic especially with the likelihood that not all crimes of market abuse are readily discoverable. Hence, this research took a comparative perspective from the laws in the England and Scotland which both have statutes dealing with limitation but unlike the Saudi law, they provide that the limitation period runs from the time the crimes was discovered. This is an important model that safeguards investors and worthy of consideration in the development of Saudi laws.

Making a comparative analysis of the approach to enforcement of rules in the KSA and the UK, this study was able to show in chapter six that the CMA, which succeeded the SAMA is the sole enforcer of market regulations in Saudi Arabia. It plays a role closely similar to what the FSA does in the UK. But, more than the FCA, the CMA has far-reaching monopoly over various issues of protection of investors, corporate governance and issues relating to mergers and acquisitions. It is also responsible for the every financial tool including IPOs, Sukuks and mutual funds. The CMA also has a role to investigate and adjudicate through the CRSD. This however is seen as a challenge to the concept of fair hearing since the CMA and its subsidiary the CRSD are the investigators, and the final adjudicative body when it comes to capital market. They not only investigate and settle dispute through the CRSD, they also have powers to issue

subpoenas. Other aspects that have raised concerns among scholars were such powers of the CRSD that it can admit evidence that was secured without warrant as against what is traditionally contained for criminal proceedings under Sec 3-4 of the Criminal Procedure law of 24/08/1422H. This difference on how offenders in the financial market are treated differently with other criminal offenders raises questions that touch on the rule of law itself. Proponents however argue that this system prevails and is successful because of the nature and characteristics of financial crimes, which must be dealt with differently with other offences.

There are other differences between the KSA and UK, especially since the abolition of the FSA, which saw the enforcement regime in the UK split, with FCA dealing with the micro-prudential and PRA dealing with the macro-prudential aspects of the market. This however can be seen from the prism of the nature of investments and the size of the two markets. The UK is among the largest in the world and such decentralisation is often necessary to ensure effective regulation. The global financial crisis of 2007/2008 is among the major reasons that brought to the fore the need to reform market regulatory framework in the UK and other countries that were heavily impacted by the crisis. The UK saw not only the split of regulatory institutions, but it also saw the enactment of the FSA 2012, which imposed further duties on the FCA which are quite similar to the CMA. The decentralised nature of the UK system can also be seen in the presence of three major bodies i.e., the PRA, the FCA and the FPC. While the FPC is responsible for the protection of the stability of the financial system, the PRA shoulders the role of ensuring that risks in the financial system are minimised by effectiveness of regulated companies. In Saudi however, every major role of regulating the financial market and enforcement is centralised in the CMA.

Also similar to the CMA, the FCA had a committee within it known as the RDC. The FCA investigates market misconducts and refers them to the RDC. This referral is similar to what is obtained in the KSA. It is however worthy to note that, parties in the UK have other options, i.e., if dissatisfied with the decision of the RDC, they can take the matter to the Upper Tribunal. Courts proceedings in the UK are open to the public. This is a departure from the system in the Saudi Arabia, which has no option of an open court trial for financial market disputes; a situation that was heavily criticised by some scholars. Another aspect that is similar between the Saudi system and the UK are issues

relating to banks and insurance companies which were in Saudi Arabia dealt with through the SAMA, which as an institution independent of the CMA.

One of the major achievements of the CMA according to this research is the abolishing of unregulated brokerage activities and introducing a standard form of IPOs. Both of these have helped in consumer confidence and investor attraction. Evidence from this study shows that the market had since grew exponentially to become the largest in the Arab Gulf region. This of course is not only due to opening the market but also because the system has introduced clear laws that protect the market from abuses and also clear penalties for offenders.

In reference to the nature of penalties for financial market offences, this study in, chapter six, has shown that Saudi Arabia and the UK both have clear criminal and civil sanctions to regulate standards of financial market conduct. What also became evident in the course of this study is that both the Saudi Arabia and the UK regulatory authorities place more emphasis in pursuing civil proceeding than criminal ones. It was found that one of the reason why this approach is most preferred is because regulators are aware of the complexity of pursuing a criminal proceeding through the CJA 1993, which involves the rigors of the traditional adversarial method in open courts. The introduction of the FSMA is therefore a step forward to enable regulators take civil actions against offender. Moreover, evidence suggest that market abuse, especially insider trading is a crime that involves a great deal of secrecy. Hence, to establish such offence beyond reasonable doubt before a criminal court is no doubt a costly exercise, with no certainty of obtaining conviction. Hence, it is prudent to emphasis on civil proceedings. Despite this however, evidence suggests that in cases of misleading statement, which are often not as difficult to prove, regulators in the UK often pursue the criminal route. Another significant area of divergence between the Saudi Arabia and the UK is the limit to the extent of penalty that can be imposed, which has limits in Saudi. But it is also important to note that, all penalties in Saudi are imposed by an administrative body and there is no court involved.

In general, this study has shown that financial market in Saudi Arabia and the UK have a number of similarities and differences. The similarities are often in the area of legislation and enforcement, while the differences are a result of some major historical,

cultural and economic aspects including the difference in the size of the two markets, the influence of Shari'ah on the Saudi financial market system and the nature of products found in both markets. What is evident is that the financial market of Saudi Arabia is still at its formative stage compared to the UK and therefore has a lot of room for reform and for future research.

## 8.2 Recommendations.

There are a number of areas in the Saudi capital market that can be improved, but it is also important to state that the kinds of risk and uncertainty of certain financial instruments in the UK and other western economies has made the system vulnerable and susceptible to crisis as much as it has also seen growth and development.

In the cause of this study, it was shown that 'securities', despite the fact that they form a major part of financial market, were not clearly defined under Saudi Arabia laws. Hence, there is the need to ensure that the law defines every principal aspect clearly in order to avoid ambiguity.

The second aspect is to do with the centralisation of all disputes under the CRSD. It is true that conventional courts in Saudi Arabia are governed solely by the principles of Shari'ah and to some foreign investors, Shari'ah laws are not applicable. Hence, there is the need to have professionals trained in both domestic and international commercial laws to head special courts/tribunals for the resolution of these disputes openly and transparently so that the CMA should stop being the investigator and the jury. Instead, they should also be a party or only an investigation and prosecuting body. The courts should be independent of the CMA.

Lastly, there is the need to not only have disputes and cases of market abuse resolved, there should be a data base to capture all these cases and their trajectories, including all the facts and circumstances in order to have a clear picture of the nature and cause of market abuse, thereby giving the opportunity to review laws and regulatory approach to check them.

In the interest of transparency, the CMA through CRSD should consider publication of details of facts and outcome of cases similar to the UK's Upper Tribunal. The current

practice of releasing a brief detail of the outcome of their decision to media or on their website without giving a thorough review of the entire case and its outcome does not suggest transparency in the system.



## Bibliography

### Books and Journal Articles

- Abdalla, M. G. E. (1997). Partnership financing for small enterprise–Problems and suggested improvements. In Partnership Financing for Small Enterprise-Some lessons from Islamic credit systems (Vol. 56, No. 61, pp. 56-61). Practical Action Publishing in association with GSE Research.
- Abraham, A., Seyyed, F. J., and Alsakran, S. A. (2002). Testing the random walk behaviour and efficiency of the Gulf stock markets. *Financial Review*, 37 (3), 469-480.
- Abrams, C. (2000). Financial Services and Markets Act: market abuse. *Amicus Curiae*, 2000(32), 22-24.
- Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Shariah Standards no. 5.
- Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) 2005, Standards no.17.
- Adam, J. N and Thomas, A. S (2005) *Islamic Bonds: Your Guide to Issuing, Structuring and Investing in Sukuk*. Euromoney Books, London.
- Accessed on 19/01/2016
- El-Hawary, Dahlia, Wafik, G. and Zamir, I. (2004). "Regulating Islamic financial institutions: The nature of the regulated." World Bank Policy Research Working Paper 3227.
- Ahmed, A. (2010). Global financial crisis: an Islamic finance perspective. *International Journal of Islamic and Middle Eastern Finance and Management*, 3, 4, 306-320.
- Al Elsheikh, A. A. A., and Tanega, J. (2011). Sukuk structure and its regulatory environment in the Kingdom of Saudi Arabia. *Law and Financial Markets Review*, 5(3), 183-200.
- Al Kahtani, F. S. (2013). *The Saudi External Institutional Framework for Corporate Governance*.

- Al-Amine, M. A. B. M. (2008). Sukuk market: Innovations and challenges. *Islamic Capital Markets*, 33.
- Al-Amine, M.B.M. (2001), "The Islamic bond market: Possibilities and challenges", *International Journal of Islamic Financial Services*, (3), 1.
- Alanazi, B. M. G. A. (2012). Investor protection and the civil liability for defective disclosures in the Saudi securities market: a legal analysis.
- Al-Baz, A. (2004). The rules of prohibited money and the rules of utilizing and using it in the Islamic law, Jordan: Dar Al-Nafaes. P 55-70.
- Alexander, K. (2001). Insider dealing and market abuse: the financial services and markets act 2000. ESRC Centre for Business Research, University of Cambridge.
- Alexander, K., Linklater, L., and Bazley, S. (2009). *Market Abuse and Insider Dealing*. Bloomsbury Professional.
- Alhabshi, S. O. (1994, January). Development of capital market under Islamic principles. In *Conference on Managing and Implementing Interest-Free Banking/Islamic Financial System*, Kuala Lumpur.
- Al-Haddad, H., and el-Diwany, T. (2010). Boom, bust, crunch: is there an Islamic solution?. Available at [http://www.islamic-finance.com/item153\\_f.htm](http://www.islamic-finance.com/item153_f.htm) Accessed, 28/09/2015
- Al-Haskafi, A. D. (2000). *Ad-Durrul Mukhtar* (Vol. 5). Karachi: H.M. Saeed Company.
- Al-Hussain, A. H. (2009). *Corporate Governance Structure Efficiency and Bank Performance in Saudi Arabia*. ProQuest.
- Al-Kahtani, F. S. (2014). Current Disclosure and Transparency Practices in Saudi Corporate Governance. *Arab Law Quarterly*, 28(2), 176-192.
- Al-Meaitheer, M. A., and Mitchell, C. J. Extending EMV to support Murabaha transactions. In *Proceedings of the 7th Nordic Workshop on Secure IT Systems (NordSec 2007)* (pp. 95-108).
- Al-Salem, F. H. (2009). Islamic financial product innovation. *International Journal of Islamic and Middle Eastern Finance and Management*, 2(3), 187-200.
- Alsayyed, N. (2010). The uses and misuses of commodity Murabaha: Islamic Economic Perspective.

- Al-Sedairy, S. T. (1994). Management of conflict: Public-sector construction in Saudi Arabia. *International Journal of Project Management*, 12(3), 143-151.
- Alserhan, B. A. (2015). *The principles of Islamic marketing*. Ashgate Publishing, Ltd.
- Al-Shamrani, A. S. (2014). *Islamic financial contracting forms in Saudi Arabia: Law and practice* (Doctoral dissertation).
- Al-Shibali, Yousouf Abdullah (no date), *Al-Khadamat al-Istithmariyyah Fi al-Masarif Wa Ahkamuha fi al-Fiqh al-Islami*, vol.2 pp-140-147.
- Alshogeathri, M. A. M. (2011). *Macroeconomic determinants of the stock market movements: empirical evidence from the Saudi Stock market* (Doctoral dissertation, Kansas State University).
- Alshowaiman, N. S. (2013). The Internet Financial Reporting by Listed Saudi Companies on Tadawul Website (Between 2004 and 2005). *Journal of Administrative and Economics Science*, 6(2).
- Al-Suhaibani, M., and Kryzanowski, L. (2000). An exploratory analysis of the order book, and order flow and execution on the Saudi stock market. *Journal of Banking and Finance*, 24(8), 1323-1357.
- Alzahrani, A. A., Gregoriou, A., and Hudson, R. (2013). Price impact of block trades in the Saudi stock market. *Journal of International Financial Markets, Institutions and Money*, 23, 322-341.
- Amico, A. (2014), "Corporate Governance Enforcement in the Middle East and North Africa: Evidence and Priorities", *OECD Corporate Governance Working Papers*, No. 15, OECD Publishing.
- Antoniou, A., Ergul, N., and Holmes, P. (1997). Market Efficiency, Thin Trading and Non-linear Behaviour: Evidence from an Emerging Market. *European Financial Management*, 3(2), 175-190.
- Arouri, M. E. H., and Rault, C. (2012). Oil prices and stock markets in GCC countries: empirical evidence from panel analysis. *International Journal of Finance and Economics*, 17(3), 242-253.
- Ashe, T.M. (1990). Insider Dealing. *Company Lawyer*, 11(7), 1-26
- Auda, J (2008) *Maqasid Al-Shari'ah as Philosophy of Islamic Law: A System Approach*. London: The International Institute of Islamic Thought, pp124
- Authority, F. C. (2013). *The FCA's approach to advancing its objectives*.

- Avgouleas, E. (2005). *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis*. Oxford University Press.
- Avgouleas, E. (2010). A new framework for the global regulation of short sales: Why prohibition is inefficient and disclosure insufficient. *Stanford Journal of Law, Business, and Finance*, 16(2).
- Ayyash, M. S. A. (2008). Shari [ah Alternatives to Non-Shari [ah Elements in Modern Commodity Futures Trading. *Islamic Capital Markets*, 147. See also, Wilson, R. (2013). The development of Islamic finance in the Gulf Cooperation Council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.
- Az-Zuhaili, W. (1985). *Al-Fiqhul-Islami-Wa-Adillatuhu*, Vol. 5 Damascus.
- Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87
- Baber, G. (2013). A critical examination of the legislative response in banking and financial regulation to issues related to misconduct in the context of the crisis of 2007-2009. *Journal of Financial Crime*, 20 (2), 237-252.
- Bainbridge, S. M. (Ed.). (2013). *Research handbook on insider trading*. Edward Elgar Publishing.
- Barth, J. R., Caprio, G., and Levine, R. (2004). Bank regulation and supervision: what works best?. *Journal of Financial intermediation*, 13 (2), 205-248.
- Barucci, E. (2012). *Financial markets theory: Equilibrium, efficiency and information*. Springer Science & Business Media.
- Basel II. See also, Lindblom, T., Sjögren, S., and Willeson, M. (2014). *Financial systems, markets and institutional changes*. Palgrave Macmillan.
- Beach, J. W. (2005). Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets, *The. Stan. J. Int'l L.*, 41, 307.
- Beck, T., Demirguc-Kunt, A. and Levine, R (2002) 'Law and Finance: Why Does Legal Origin Matter? NEBER Working Paper No. 9379, JEL No. G2, K2, K4, O16, P5. <<http://www.nber.org/papers/w9379.pdf>> [Accessed on: 29th July 2012] p. 1

- Bentham, J. (1843). A manual of political economy. History of Economic Thought Books; Director, A. (1964). Parity of the Economic Market Place, The. JL & Econ., 7, 1.
- Bentham, J. (1843). A manual of political economy. History of Economic Thought Books.
- Bianchi, R. R. (2006). Revolution in Islamic Finance. The Chicago Journal of International Law, 7, 569-580.
- Bichler, M. (2000). Trading financial derivatives on the Web—an approach towards automating negotiations on OTC Markets. Information Systems Frontiers, 1(4), 401-414.
- Billah, M. M. (2001). Principles and practices of takaful and insurance compared. Malaysia: GECD Printing Sdn. Bhd.
- Blundell-Wignall, A., and Atkinson, P. (2010). Thinking beyond Basel III: Necessary solutions for capital and liquidity. OECD Journal: Financial Market Trends, 2010(1), 1-23
- Board of the Capital Market Authority Resolution No. 1-39-2008, 3/12/1429H (Jan. 12, 2008)
- Bovard, J. (1991). The Fair Trade Fraud: How Congress Pillages the Consumer and Decimates American Competitiveness. Palgrave Macmillan.
- Brandt, P. (2013). Changing of the guard. International Financial Law Review, 32, 41.
- Bremmer, I. (2010). The end of the free market: who wins the war between states and corporations?. European View, 9(2), 249-252.
- Bris, A. (2005). Do insider trading laws work? European Financial Management, 11(3), 267-312.
- Brown, D. (1998). Economic Justice: The Market Socialist Vision. Journal of Economic Issues, 32(4), 1189-1193.
- Burbidge, J., and Harrison, A. (1984). Testing for the effects of oil-price rises using vector autoregressions. International Economic Review, 459-484.
- Burger, R. (2007). A principled front in the war against market abuse. Journal of Financial Regulation and Compliance, 15(3), 331-336.
- Caouette, J. B., Altman, E. I., and Narayanan, P. (1998). Managing credit risk: the next great financial challenge (Vol. 2). John Wiley and Sons.

- Cattelan, V. (2009). From the concept of haqq to the prohibitions of riba, gharar and maysir in Islamic finance. *International Journal of Monetary Economics and Finance*, 2(3-4), 384-397.
- Chakravarty, S., and McConnell, J. J. (1997). An analysis of prices, bid/ask spreads, and bid and ask depths surrounding Ivan Boesky's illegal trading in Carnation's stock. *Financial Management*, 18-34.
- Chiarella v. U.S., 1980 at 248. See also, U.S. v. Carpenter, 1986/ 1987
- Cho, J. Y., and Shaub, M. K. (1991). The consequences of insider trading and the role of academic research. *Business & Professional Ethics Journal*, 83-98.
- Chong, B. S., and Liu, M. H. (2009). Islamic banking: interest-free or interest-based? *Pacific-Basin Finance Journal*, 17(1), 125-144
- Collett, N. 1995. "The Preferred Option." *Asset finance and Leasing Digest* 219:12. See also *Islamic Banking Means Western Opportunity*, Nurul Islam, *Business Journal*, August 4, 2008. Available at <http://www.gallup.com/businessjournal/109360/islamic-banking-means-western-opportunity.aspx#!mn-business>. Accessed on 13/01/2016
- Cornell, B., and Sirri, E. R. (1992). The reaction of investors and stock prices to insider trading. *Journal of Finance*, 1031-1059.
- Crotty, J. (2009). Structural causes of the global financial crisis: a critical assessment of the 'new financial architecture'. *Cambridge Journal of Economics*, 33(4), 563-580.
- Crawford, Fred. 2000. "Developing Financial Products in Islamic Finance," Paper Presented at the Fourth Islamic Finance Program at Harvard University on September 30/October 1, 2000, Boston, Massachusetts.
- Cumming, D., Zhan, F., and Aitken, M. (2012). Exchange Trading Rules, Surveillance, and Insider Trading. *Surveillance and Insider Trading*.
- Dabbah, M. M. (2007). *Competition Law and Policy in the Middle East*. Cambridge University Press.
- Danielsson, J., Embrechts, P., Goodhart, C., Keating, C., Muennich, F., Renault, O., and Shin, H. S. (2001). An academic response to Basel II.
- Dar, H and Azami, M. T. A. eds. (2011) 'Regulatory Issues: Challenges and Solutions'. *Global Islamic Finance Report*. London: BMB Islamic UK Limited.

- Dejmek, P. (2008). EU Internal Market for Financial Services-A Look at the First Regulatory Responses to the Financial Crisis and a View to the Future, *The. Colum. J. Eur. L.*, 15, 455.
- Diamond, D. W., and Rajan, R. G. (2005). Liquidity shortages and banking crises. *The Journal of finance*, 60(2), 615-647.
- Dignam, A., and Lowry, J. (2006), *Company Law* .4th Edn., Oxford University Press.
- Dine, J. (2001). *Company Law*, 4th Ed, Palgrave, Basingstoke. See also, *Mackie v HMA* [1994] JC 132
- Director, A. (1964). Parity of the Economic Market Place, *The. JL & Econ.*, 7, 1.
- Dubai International Financial Centre Sukuk Guidebook. See, also <http://www.islamicbanker.com/education/Sukuk-al-Istisna>
- Dudley Nigel (1998). "Islamic banks aim for the mainstream." *Euromoney*, London. 349, 113-116.
- Duffie, D., Gârleanu, N., & Pedersen, L. H. (2005). Over-the-Counter Markets. *Econometrica*, 73(6), 1815-1847.
- Dupret, B., Berger, M., and Al-Zwaini, L. (Eds.). (1999). *Legal pluralism in the Arab world* (Vol. 18). BRILL.
- Dusuki, A. W. (2010). Do equity-based Sukuk structures in Islamic capital markets manifest the objectives of Shari'ah? *Journal of Financial Services Marketing*, 15(3), 203-214. See also Wilson, R. (2013). The development of Islamic finance in the Gulf Cooperation Council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.
- Easton, G. (2002). Marketing: a critical realist approach. *Journal of business research*, 55(2), 103-109.
- Ebrahim, M.S. (2000), "Pricing asset backed Islamic financial instruments", *International Journal of Theoretical and Applied Finance*, (3) 1. 51-83.
- Ebrahim, M.S. and Joo, T.K. (2001), "Islamic banking in Brunei Darussalam", *International Journal of Social Economics*, (28), 4, 314-337.
- El Qorchi, M. (2005). Islamic finance gears up. *Finance and Development*, 42(4), 46.

- Elfakhani, S., Hassan, M. K., and Sidani, Y. (2005, December). Comparative performance of Islamic versus secular mutual funds. In 12th Economic Research Forum Conference in Cairo, Egypt (pp. 19-21).
- El-Gamal, M. A (2002). Islamic finance: Law, economic and practice, Cambridge University Press, Cambridge.
- El-Gamal, M. A. (2003). Interest and the paradox of contemporary Islamic law and finance. *Fordham International Law journal*, 27, 108-149.
- El-Gamal, M. A. (2006). Islamic finance: Law, economics, and practice. Cambridge University Press.
- El-Gamal, M. A. (2007). Mutualization of Islamic banks. *Handbook of Islamic Banking*.
- Ellis, T. R. (2012). The Piety Premium of Islamic Bonds. *Middle East Quarterly*.
- Errico, M. L., and Farahbaksh, M. M. (1998). Islamic banking: issues in prudential regulations and supervision. *International Monetary Fund*.
- Everett, J., and Watson, J. (1998). Small business failure and external risk factors. *Small Business Economics*, 11(4), 371-390
- Farooq, M. O. (2006). Riba, interest and six hadiths: do we have a definition or a conundrum?. Unpublished essay, available online. At <http://www.assaif.org/chi/content/download/33174/174384/file/Riba-hadith.pdf>/p26.
- Fasano, U., and Iqbal, Z. (2003). GCC countries: from oil dependence to diversification. *International Monetary Fund*.
- Febianto, I. (2009). Shari'ah Compliant Model of Business Entities online available at <http://www.wbiconpro.com/350-Irawan.pdf>.
- Ferran, E. (2011). The Reorganisation of Financial Services Supervision in the UK: An Interim Progress Report. *University of Cambridge Faculty of Law Research Paper*, (49).
- Ferran, E., and Goodhart, C. (Eds.). (2001). *Regulating Financial Services and Markets in the 21st Century*. Bloomsbury Publishing.
- Ferrarini, G. A. (2004). The European Market Abuse Directive. *Common Market Law Review*, 41(3), 711-741.



- Filby, M. (2003). Part VIII Financial Services and Markets Act: Filling Insider Dealing's Regulatory Gaps. See also, Barnes, P. (2009). Stock market efficiency, insider dealing and market abuse: the UK experience. *International Journal of Business Governance and Ethics*, 5(1-2), 38-50.
- Gavin, M., and Hausmann, R. (1996). The roots of banking crises: the macroeconomic context.
- Gieve, S. J. (2006). Financial System Risks in the United Kingdom-Issues and Challenges. *Bank of England Quarterly Bulletin*, Fall.
- Gilson, R. J. (2001). Globalizing corporate governance: Convergence of form or function. *The American Journal of Comparative Law*, 329-357.
- Godlewski, C. J., Turk-Ariss, R., and Weill, L. (2013). Sukuk vs. conventional bonds: A stock market perspective. *Journal of Comparative Economics*, 41(3), 745-761.
- Gootlieb, C. (2014) MAD II Adopted by European Parliament and Council. Alert Memorandum
- Gouda, B. A. (2012). Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003, *The Ann. Surv. International and Comp. L.*, 18, 115.
- Grosse, R. (2012). Bank regulation, governance and the crisis: a behavioural finance view. *Journal of Financial Regulation and Compliance*, 20(1), 4-25.
- Hallaq, W. B. (1986). On the Origins of the Controversy about the Existence of Mujtahids and the Gate of Ijtihad. *Studia Islamica*, 129-141.
- Hammad, Nazih (2007), "Takyif Sharikatai al-[Aqd wa Atharuhu fi Tatbiqat al-Sukuk wa al-Musharakah al-Mutanaqisah]", paper presented at the Fifth Shari'ah Conference organized by the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), February, 2007. Bahrain.
- Hannigan, B. (1994). *Insider Dealing*. London: Longman, 2nd edn.
- Hannoun, H. (2010). The Basel III capital framework: a decisive breakthrough. discurso pronunciado en el seminario de alto nivel BoJ-BIS Financial Regulatory Reform: Implications for Asia and the Pacific, [www. bis.org/speeches/sp101125a. pdf](http://www.bis.org/speeches/sp101125a.pdf).
- Horowitz, N. (2014). *Art of the deal: Contemporary art in a global financial market*. Princeton University Press.

- Hassan, O. A., Giorgioni, G., and Romilly, P. (2006). The extent of financial disclosure and its determinants in an emerging capital market: the case of Egypt. *International Journal of Accounting, Auditing and Performance Evaluation*, 3(1), 41-67.
- Henderson, A. (2007). Limiting the regulation of Islamic finance: lessons from Dubai. *Law and Fin. Mkt. Rev.*, 1, 213-243.
- Hoepner, A. G., Rammal, H. G., and Rezek, M. (2011). Islamic mutual funds' financial performance and international investment style: Evidence from 20 countries. *The European Journal of Finance*, 17(9-10), 829-850.
- Homoud, Sami, 'Islamic financial instruments based on intermediary contracts', *Islamic Financial Instruments for Public Resource*.
- Howcroft, et al. (2007). Customer involvement and interaction in retail banking: an examination of risk and confidence in the purchase of financial products. *Journal of Services Marketing*, 21(7), 481-491, p488.
- Ibn-un-Nujaim, Z. U. A. (2004). *Al-Ashbah Wan-Nazair*. Karachi: Idara-tul-Qur'an Wal- Uloom-ul Islamiyyah.
- Ibrahim, A. A. (2006). Convergence of corporate governance and Islamic financial services industry: toward Islamic financial services securities market. *Georgetown Law Graduate Paper Series*, 3.
- Iqbal, M. (2001) *Islamic Banking and Finance: Current Developments in Theory and Practice*. Leicester: The Islamic Foundation. pp. 19 – 20.
- Iqbal, Z., and Mirakhor, A. (2004). Stakeholders model of governance in Islamic economic system.
- Iqbal, Z., and Mirakhor, A. (2011). *An introduction to Islamic finance: theory and practice*. John Wiley and Sons.
- Islahi, Abdul Azim, *Economic Concepts of Ibn Taimiyah* (Leicester: The Islamic Foundation, 1988), pp. 75–102. See also Wilson, R. (2013). The development of Islamic finance in the Gulf Cooperation Council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.
- Islamic Fiqh Academy, *Majallat Majma' al-Fiqh Al-Islamic*.
- Ismayil, S. I. (2012). *The Principles of Islamic Finance, Its Challenges and Policy Suggestions for Azerbaijan* (Doctoral dissertation, Eastern Mediterranean University (EMU)).

- Issa, N., and Stull, J. (2014). Saudi Arabia: Steady Growth amidst New Regulations. *The Islamic Finance Handbook: A Practitioner's Guide to the Global Markets*, 421-432.
- Jabeen, Z., and Khan, M. R. (2008). An Inquiry into the Usage of Real Assets in Islamic Transactions and Their Benchmarking: The Implications for Islamic Capital Markets. *Islamic Capital Markets*, 69.
- Jackson, H. E., and Roe, M. J. (2009). Public and private enforcement of securities laws: Resource-based evidence. *Journal of Financial Economics*, 93(2), 207-238.
- Jaffer, S. (2005). Islamic retail banking and finance: global challenges and opportunities. *Linnius*.
- Jalil, M. A., and Rahman, M. K. (2010). Financial transactions in Islamic Banking are viable alternatives to the conventional banking transactions. *International Journal of Business and Social Science*, 1(3), 220-234.
- Jesper-Lau, H. (2009). What constitutes insider dealing? *International and Comparative Corporate Law Journal*, SSRN available at <http://ssrn.com/abstract=1499093>
- Jobst, A. A. (2007). Derivatives in Islamic finance. *Islamic Economic Studies*, 15(1).
- Jobst, A. A. (2007). The economics of Islamic finance and securitization. *IMF Working Papers*, 1-35.
- Kamali, M. H. (2000), *Principles of Islamic Jurisprudence*, Kuala Lumpur: Ilmiyyah Publishers, pp.367-370.
- Kamali, M. H. (2007). A Shari'ah analysis of issues in Islamic leasing. *Islamic Economics*, 20(1).
- Karmel, R. S. (1998). Outsider Trading on Confidential Information-A Breach in Search of a Duty. *Cardozo L. Rev.*, 20, 83.
- Kettell, B. Murabaha as a Mode of Islamic Finance. *Introduction to Islamic Banking and Finance*, 43-61.
- Khan, M. M., Alam, H. M., Ahmad, N., Iqbal, M. S., and Ali, S. (2011). Comparative analysis of Islamic and prevailing insurance practices. *International Journal of Business and Social Science*, 2(10), 282.

- Khan, Z., Jawaid, S. T., Arif, I., and Khan, M. N. (2012). Working capital management and firm's profitability in Pakistan: A disaggregated analysis. *African Journal of Business Management*, 6(9), 3253-3261.
- Khatkhatay, M. H., and Nisar, S. (2007). Shari'ah compliant equity investments: An assessment of current screening norms. *Islamic Economic Studies*, 15(1), 47-76.
- Kobayashi, Y. (2007). Corporate strategies of Saudi Aramco. The James A Baker III Institute for Public Policy, Rice University, Texas, US.
- Kroszner, R. S., Laeven, L., and Klingebiel, D. (2007). Banking crises, financial dependence, and growth. *Journal of Financial Economics*, 84 (1), 187-228.
- Kuran, T. (1997). The genesis of Islamic economics: a chapter in the politics of Muslim identity. *Social Research*, 301-338; Chapra, M. U (2004) Mawlana Mawdudi's Contribution to Islamic Economics. *94 Muslim World*, 94, 163-
- La Porta et al. (2002). Investor protection and corporate valuation. *Journal of finance*, 1147-1170.
- Lahsasna, A. (2013). *Maqasid Al-Shari'ah in Islamic Finance*. Kuala Lumpur: Institute of Banking and Finance Malaysia.
- Langevoort, D. C. (1982). Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement. *California Law Review*, 1-53.
- Lawson, G. (1988). Ethics of Insider Trading, *The Harv. JL & Pub. Pol'y*, 11, 727.
- Le Leslé, V., and Avramova, S. Y. (2012). Revisiting risk-weighted assets.
- Lekkas, P. (1998). Insider trading and the Greek stock market. *Business Ethics: A European Review*, 7(4), 193-199.
- Levich, R. M. (2001). *International financial markets*. McGraw-Hill/Irwin.
- Levine, R. (2012). The governance of financial regulation: reform lessons from the recent crisis. *International Review of Finance*, 12(1), 39-56.
- Licht, A. N. (2000). The mother of all path dependencies: Toward a cross-cultural theory of corporate governance systems. Available at SSRN 208489.
- Luciani, G. (2005). From private sector to national bourgeoisie: Saudi Arabian business. *Saudi Arabia in the Balance: Political Economy, Society, Foreign Affairs*, 144-181.

- Ma, Y., and Sun, H. L. (1998). Where should the line be drawn on insider trading ethics?. *Journal of Business Ethics*, 17(1), 67-75.
- Macey, J. R. (1984). From Fairness to Contract: The New Direction of the Rules Against Insider Trading. *Hofstra L. Rev.*, 13, 9.
- MacNeil, I. (1999). The Future for Financial Regulation: The Financial Services and Markets Bill. *The Modern Law Review*, 62(5), 725-743.
- Mahayni, Z. (2013). An Analysis of Capital Market Regulation in Saudi Arabia (Doctoral dissertation, University of Leicester).
- Maidin, A. J. (2011). Islamic principles on sustainable land use planning and development. *Journal of Islamic Law Review*, 7(1), 57-89.
- Malkawi, B. H. (2006). Anatomy of the Case of Arab Countries and the WTO. *Arab Law Quarterly*, 20, 2, 110-151, p1.
- Mangelsdorf, A. (2005). The EU market abuse directive: Understanding the implications. *Journal of Investment Compliance*, 6(2), 30-37.
- Manne, H. (1966) *Insider Trading and the Stock Market*. The Free Press, New York
- Manne, H. G. (1969). Rejoinder To Mr. Ferber, A. *Vand. L. Rev.*, 23, 627.
- Manne, H. G. (1984). Insider trading and property rights in new information. *Cato J.*, 4, 933.
- Manove, M. (1989). The harm from insider trading and informed speculation. *The Quarterly Journal of Economics*, 823-845.
- Mansoor Ibn Yunus, A.-B. (2002). *Kashshaaf-ul-Qinaa'* (Vol. 3). Beirut: Dar-ul-Fikr.
- Marar, A. D. (2004). Saudi Arabia: The Duality of the Legal System and the Challenge of Adapting Law to Market Economies. *Arab Law Quarterly*, 19(1), 91-124.
- Maysami, R. C., and Kwon, W. J. (1999). An analysis of Islamic Takaful insurance: A cooperative insurance mechanism. *Journal of Insurance Regulation*, 18(1), 109.
- McGee, R. W. (2008). Applying Ethics to Insider Trading. *Journal of Business Ethics*, 77, 205-217
- McGee, R. W. (2010). Analyzing insider trading from the perspectives of utilitarian ethics and rights theory. *Journal of Business Ethics*, 91(1), 65-82.

- McMillen, M. J. (2006). Islamic capital markets: developments and issues. *Capital Markets Law Journal*, 1(2), 136-172.
- McVea, H. (1995). What's wrong with insider dealing? 13(3) *Legal Studies*, 390-406
- Meera, M., Kameel, A., and Abdul Razak, D. (2005). Islamic Home Financing through Musharakah Mutanaqisah and al-Bay' Bithaman Ajil Contracts: A Comparative Analysis. *Review of Islamic Economics*, 9 (2), 5-30.
- Merdad, H., Hasan, M. K., and Alhenawi, Y. (2010). Islamic versus conventional mutual funds performance in Saudi Arabia: a case study. *Islamic Economics*, 23(2).
- Mill, J. S., & Lerner, M. (1965). *Essential Works of John Stuart Mill*.
- Minenna, M. (2003). The detection of market abuse on financial markets: A quantitative approach. *Quaderni di finanza*, (54).
- Mirakhor, A. (1996), "Cost of capital and investment in a non- interest economy", *Islamic Economic Studies*. (4), 1, 35-46.
- Moloney, N. (2010). EU financial market regulation after the global financial crisis: "more Europe" or more risks?. *Common Market Law Review*, 47(5), 1317-1383.
- Moore, J. (1990). What is really unethical about insider trading?. *Journal of Business Ethics*, 9 (3), 171-182.
- Moore, M. T., and Walker-Arnott, E. (2014). A Fresh Look at Stock Market Short-termism. *Journal of Law and Society*, 41(3), 416-445
- Moore, M. T., and Walker-Arnott, E. (2014). A Fresh Look at Stock Market Short-termism. *Journal of Law and Society*, 41(3), 416-445.
- Muhammad al-Amine, Muhammad al-Bashir (2010). 'The Islamic bonds market: possibilities and challenges', *International Journal of Islamic Financial Services*, (3), 1, 1-18.
- Muneeza, A., and Hassan, R. The Legal Conflicts in Shari'ah Corporate Governance of Islamic Financial Institutions in Malaysia.
- Musikali, L. M. (2009). Why Criminal Sanctions Still Matter in Corporate Governance. *International Company and Commercial Law Review*, 20(4), 133-141.
- Muslim, I. U (2000). *Sahih Muslim* (Vol. 6). Beirut: Dar El-Mareefah.

- Neaime, S. (2012). The global financial crisis, financial linkages and correlations in returns and volatilities in emerging MENA stock markets. *Emerging Markets Review*, 13(3), 268-282.
- Nick, T., and Hanna, C. (2010). *An Introduction to the Principal Stock Exchanges of the UAE, Saudi Arabia, Kuwait and Bahrain*. Gibson Dunn publications
- Nida'ul Islam, in Wahab, A. R. A., Lewis, M. K., and Hassan, M. K. (2007). Islamic Takaful: Business models, Shari'ah concerns, and proposed solutions. *Thunderbird International Business Review*, 49(3), 371-396.
- Nienhaus, V. (2011). Islamic finance ethics and Shari'ah law in the aftermath of the crisis: Concept and practice of Shari'ah compliant finance. *Ethical perspectives-Katholieke Universiteit Leuven*, 18(4), 591-623.
- Obaidullah, M. (2001). Ethics and efficiency in Islamic stock markets. *International Journal of Islamic Financial Services*, 3(2), 1-10.
- O'Hara, P. A. (2001). Insider trading in financial markets: legality, ethics, efficiency. *International Journal of Social Economics*, 28(10/11/12), 1046-1063.
- Oseni, U. A., and Hassan, M. K. (2014). Regulating the governing law clauses in Sukuk transactions. *Journal of Banking Regulation*.
- Osman, F. (1999). *Concepts of the Qur'an: A Topical Reading*. Los Angeles: MVI Publications.
- Othman, M. S., and Abdul Hamid, M. (2009). A study on the level of knowledge and understanding among muslims towards the concepts, arabic and Shari'ah terms in Islamic insurance (Takaful). *European Journal of social sciences*, 10(3), 468-478.
- Paredes, T. A. (2003). *Systems Approach to Corporate Governance Reform: Why Importing US Corporate Law Isn't the Answer*, *A. Wm. & Mary L. Rev.*, 45, 1055.
- Pigou, A. C. (2013). *The economics of welfare*. Palgrave Macmillan.
- Pistor, K., and Xu, C. (2002). Law enforcement under incomplete law: Theory and evidence from financial market regulation. *LSE STICERD Research Paper No. TE442*.

- Qazi, B. A. (2014). Shari'ah Rulings of Price Intervention (Tas' eer) and its Contemporary Applications. In *The Name of Allah, The most Beneficent, The most Merciful*, 11.
- Ramady, M. A. (2010). *The Saudi Arabian economy: Policies, achievements, and challenges*. Springer Science and Business Media.
- Ramady, M. A. (2010). *The Saudi Capital Market*. In *The Saudi Arabian Economy*. Springer US.
- Ray, N. D. (1995). *Arab Islamic banking and the renewal of Islamic law*. Graham and Trotman.
- Reardon, T., and Timmer, C. P. (2007). Transformation of markets for agricultural output in developing countries since 1950: How has thinking changed?. *Handbook of agricultural economics*, 3, 2807-2855.
- Repullo, R. (1999). Some remarks on Leland's model of insider trading. *Economica*, 66(263), 359-374.
- Ribstein, L. E. (2002). Market vs. regulatory responses to corporate fraud: A critique of the Sarbanes-Oxley Act of 2002. *J. Corp. L.*, 28, 1. See also, Alexander, K., Linklater, L., & Bazley, S. (2009). *Market Abuse and Insider Dealing*. Bloomsbury Professional.
- Rider, A., and Linklater, L. (2002). *Market abuse and Insider dealing*, Butterworths, London.
- Riley, C. A. (1992). Contracting out of company law: Section 459 of the Companies Act 1985 and the role of the courts. *The Modern Law Review*, 55(6), 782-802.
- Robertson, C., Al-AlSheikh, S., and Al-Kahtani, A. (2012). An Analysis of Perceptions of Western Corporate Governance Principles in Saudi Arabia. *International Journal of Public Administration*, 35(6), 402-409.
- Rohmatunnisa, D. (2008). *Design of Ijarah Sukuk*. Unpublished MA in Finance and Investment, University of Nottingham, Nottingham, UK.
- Rosly, S. A. (2005). *Critical issues on Islamic banking and financial markets: Islamic economics, banking and finance, investments, Takaful and Financial Planning*. Dinamas Publishing.
- Rothbard, M. N. (1997). *The logic of action two*. Books.



- Rubin, P. H. (1982) Common law and statute law *Journal of Legal Studies*, 11, 2, 205-233; Bailey, M. J., and Rubin, P. H. (1994). A positive theory of legal change. *International Review of Law and Economics*, 14, 4, 467–477.
- Said, D. (2007). Does the Use of Sukuk (Islamic bonds) Impact Islamic Banks Performances? A Case Study of Relative Performance during 2007-2009. A Case Study of Relative Performance during, 2009.
- Salbu, S. R. (1989). A Legal and Economic Analysis of Insider Trading: Establishing an Appropriate Sphere of Regulation. *Business & Professional Ethics Journal*, 3-21.
- Salbu, S. R. (1992). Misappropriation Theory of Insider Trading: A Legal, Economic, and Ethical Analysis, *The Harv. JL & Pub. Pol'y*, 15, 223.
- Salinas, F. (2008). Harmonisation Is the Key to Success. *International Fin. L. Rev.*, 27, 50.
- Schill, S. W. (2009). Multilateralizing investment treaties through most-favored-nation clauses. *Berkeley J. Int'l Law*, 27, 496.
- Schotland, R. A. (1967). Unsafe at any price: a reply to Manne, insider trading and the stock market. *Virginia Law Review*, 1425-1478.
- Segrado, C. (2005). Case study “Islamic microfinance and socially responsible investments”. Italy: MEDA Project.
- Seligman, J. (2004). *Fundamentals of securities regulation*. Aspen Publishers Online.
- Sen, P.M.(n.d.). “The Malaysian Islamic bonds market: An investigation of Sukuk and avenue of possible enhancement”.
- Shallah, R. A. (1989). *Islamic banking in an interest-based economy: a case study of Jordan*. Durham theses, Durham University. Available at Durham E-Theses Online: <http://etheses.dur.ac.uk/948>. Accessed on 14/04/2015.
- Shell, G. R. (2001). ‘When Is It Legal To Trade on Inside Information?’ MIT Sloan Management Review (Fall).
- Shleifer, A. (2005) ‘Understanding Regulation’. *European Financial Management*, Vol. 11, No. 4, pp.440–445. Available at [http://scholar.harvard.edu/sites/scholar.iq.harvard.edu/files/shleifer/files/02\\_eufm00121.pdf](http://scholar.harvard.edu/sites/scholar.iq.harvard.edu/files/shleifer/files/02_eufm00121.pdf) [Accessed On: 09/09/2012]

- Siddiqi, M. N. (2007). Economics of Tawarruq: how its Mafasid overwhelm the Masalih. In Tawarruq Seminar organised by the Harvard Islamic Finance Programme, at London School of Economics, London, UK on (Vol. 1).
- Siddiqui, A. (2008). Financial contracts, risk and performance of Islamic banking. *Managerial Finance*, 34(10), 680-694.
- Siddiqui, S. H. (2001). Islamic banking: true modes of financing. *New Horizon*, 109, 15-20.
- Simmons, B. A. (2001). The international politics of harmonization: the case of capital market regulation. *International Organization*, 55(03), 589-620.
- Smolo, E., and Kabir Hassan, M. (2011). The potentials of Musharakah mutanaqisah for Islamic housing finance. *International Journal of Islamic and Middle Eastern Finance and Management*, 4(3), 237-258.
- Sole, J. A. (2007). Introducing Islamic banks into western banking systems. *IMF Working Papers*, 1-26.
- Sole, M. J., and Jobst, A. (2012). Operative Principles of Islamic Derivatives: Towards a Coherent Theory (No. 12-63). *International Monetary Fund*.
- Soliman, M. (2013). Ownership Concentration and Firm Financial Performance- Evidence from Saudi Arabia. Available at SSRN 2257832.
- Sommer Jr, A. A. (1996). IOSCO: its mission and achievement. *Nw. J. Int'l L. & Bus.*, 17, 15.
- Squires, G. D. (2004). Why the poor pay more: How to stop predatory lending. *Greenwood Publishing Group*, p 2
- Staritz, C., and Küblböck, K. (2013). Re-regulation of commodity derivative markets: Critical assessment of current reform proposals in the EU and the US (No. 45). Working Paper, Austrian Foundation for Development Research (ÖFSE).
- Stigler, G. J. (1971). The theory of economic regulation. *The Bell journal of economics and management science*, 3-21.
- Stiglitz, J. E. (1993). The role of the state in financial markets (Vol. 21). *Institute of Economics, Academia Sinica*.p23.
- Stringham, E. P. (2002). The emergence of the London stock exchange as a self-policing club. *Journal of Private Enterprise*, 17(2), 1-19.

- Strudler, A., and Orts, E. W. (1999). Moral principle in the law of insider trading. *Tex. L. Rev.*, 78, 375.
- Sundararajan, V., and Errico, L. (2002). *Islamic financial institutions and products in the global financial system: Key issues in risk management and challenges ahead* (Vol. 2). International Monetary Fund.
- Swan, E. (2004) Market Abuse: a new duty of fairness 25(3) *Company Lawyer*, 67- 68.
- Swan, E. (2004). Market Abuse: a new duty of fairness 25(3) *Company Lawyer* 67-68, p67
- Swan, E. J., and Virgo, J. (2010). *Market abuse regulation*. Oxford University Press.
- Taher, N. (2004), A Clearer Path For Investors. *Banker*, 12, as cited in Baamir, A. Y. (2008). Issues of Transparency and Disclosure in the Saudi Stock Market. *Arab Law Quarterly*, 22(1), 63-87
- Tariq Talib al-Anjari. "Islamic Economics and Banking," Available at [http://islamic-world.net/economics/economic\\_banking\\_01.htm](http://islamic-world.net/economics/economic_banking_01.htm); Accessed on 07/02/2014
- Thapa, R. (2010). Insider Trading: A Brief Overview of Legal Regime in USA, UK, India and Nepal *Mirmire-Economic Article Special Issue*, Vol. 38, No. 293. Available at SSRN: <http://ssrn.com/abstract=1599212>.
- The Financing Role of the Saudi Capital Market Promising Prospects. Aljazira group Research Department Economic Reports (2010) This is especially contained in Chapters 4-6.
- Tomkins, C., and Karim, R. A. A. (1987). The Shari'ah and its Implications for Islamic Financial Analysis: An Opportunity to Study Interactions among Society, Organisations and Accounting. *The American Journal of Islamic Social Sciences*, 4(1).
- Thuen-Paulsen, T. K. (2016). Most Favoured Nation-Clauses
- Tucker, P., Hall, S., and Pattani, A. (2013). Macro-prudential policy at the Bank of England. *Bank of England Quarterly Bulletin*, Q3.
- Turner, A. (2009). *The Turner Review: A regulatory response to the global banking crisis* (Vol. 7). London: Financial Services Authority.

- Ullah, S., and Jamali, D. (2010). Institutional investors and corporate social responsibility: the role of Islamic financial institutions. *International review of business research papers*, 6, 1, 619-630.
- Underdal, A., and Young, O. R. (Eds.). (2004). *Regime consequences: methodological challenges and research strategies*. Springer.
- Usmai, M. T (2002). *An Introduction to Islamic Finance*. The Hague: Kluwer Law International.
- Alexander, K., & Maly, V. (2015). The new EU market abuse regime and the derivatives markets. *Law and Financial Markets Review*, 1-8.
- Usmani, M. I. A., and Ansari, J. A. (2010). Meezan bank's guide to Islamic banking. *Research Journal Of The Institute Of Business Administration Karachi-Pakistan*, 5(1), 171.
- Uusmani, M. T., and Taqī 'Uṣmānī, M. (2002) discussed this aspect taking reference from hadith of the Holy Prophet, (SAW) contained in Bukhari, *Kitab al-Buyu'*, Bab idha arada bay'a tamrin bi tamrin khayrun minhu.
- Uusmani, M. T., and Taqī 'Uṣmānī, M. (2002). *An introduction to Islamic finance*. Brill, 20.
- Valitov, S. M., and Nigmatzyanov, A. A. (2014). Modern principles of financial services markets regulation as a response to the financial and economic crisis of 2008. *Mediterranean Journal of Social Sciences*, 5(24), 285
- Ventoruzzo, M. (2014). Do Market Abuse Rules Violate Human Rights? The Grande Stevens v. Italy Case. The Grande Stevens v. Italy Case (October 2014). European Corporate Governance Institute (ECGI)-Law Working Paper, (269).
- Vogel, F. E. and Hayes, S. L. (1998), *Islamic law and finance: Religion, risk and return*, Kluwer Law International, The Hague.
- Wade, R. (1990). *Governing the market: Economic theory and the role of government in East Asian industrialization*. Princeton University Press.
- Wahab, A. R. A., Lewis, M. K., and Hassan, M. K. (2007). Islamic Takaful: Business models, Shari'ah concerns, and proposed solutions. *Thunderbird International Business Review*, 49(3), 371-396.
- Warde, I. (2000) *Islamic Finance In The Global Economy*. Edinburgh University Press, Edinburgh.

- Werhane, P. H. (1989). The ethics of insider trading. *Journal of Business Ethics*, 8 (11), 841-845.
- Williams, B. (1973). A critique of utilitarianism, in, Smart JJC, Williams B: *Utilitarianism: For and Against*.
- Wilson, R. (2004). Overview of the Sukuk market. *Islamic Bonds: Your Guide to Issuing, Structuring and Investing in Sukuk*, Euromoney Books, London, 6-7.
- Wilson, R. (2006). Islam and business. *Thunderbird International Business Review*, 48(1), 109-123.
- Wilson, R. (2006). Regulatory challenges posed by Islamic capital market products and services. Centre for Middle Eastern and Islamic Studies, University of Durham, UK.
- Wilson, R. (2013). The development of Islamic finance in the Gulf Cooperation Council states. *The Transformation of the Gulf: Politics, Economics and the Global Order*, 146.
- Winn, J. K. (1998). Regulating the Use of the Internet in Securities Markets. *The Business Lawyer*, 54(1), 443-458.
- Wurgler, J (2000) 'Financial Markets and Allocation of Capital. In: *Journal of Financial Economics*, vol. 58, p. 188
- Wymeersch, E. (2010). The institutional reforms of the European Financial Supervisory System, an interim report. Ghent Univ. Financial Law Institute Working Paper, (2010-01).
- Yasseri, Ali, 'The experiences of the Islamic Republic of Iranian Musharakah financing', *Arab Law Quarterly* (1999), pp. 231–244.
- Zaher, T. S., and Kabir Hassan, M. (2001). A comparative literature survey of Islamic finance and banking. *Financial Markets, Institutions and Instruments*, 10(4), 155-199.

#### **Websites and other internet sources**

- [http://ec.europa.eu/internal\\_market/company/infringements/index\\_n.htm](http://ec.europa.eu/internal_market/company/infringements/index_n.htm). Accessed 17/08/2014.
- [http://europa.eu/rapid/press-release\\_MEMO-14-77\\_en.htm?locale=en](http://europa.eu/rapid/press-release_MEMO-14-77_en.htm?locale=en). Accessed 12/09/2015.

- <https://www.lexology.com/library/detail.aspx?g=912d96de-9493-434f-8a89-ba0cc701cff0>
- Adil Salihi Permissibility of Life Insurance Arab News, 02/09/2004  
<http://www.aljazeera.info/Islam/Islamic%20subjects/2004%20subjects/February/Permissibility%20of%20Life%20Insurance,%20Adil%20Salahi.htm>.  
Accessed 19/12/2013
- [http://www.blackstonechambers.com/news/cases/fca\\_v\\_da\\_vinci.html](http://www.blackstonechambers.com/news/cases/fca_v_da_vinci.html).  
Accessed 19/06/2016
- <http://money.cnn.com/2015/04/16/investing/saudi-arabia-stock-exchange-opens-to-foreigners-june-15/> Accessed on 09/10/2015.
- [http://www.aljaziracapital.com.sa/report\\_file/ess/eco-4.pdf](http://www.aljaziracapital.com.sa/report_file/ess/eco-4.pdf). Accessed 23/01/2014
- <http://www.arabnews.com/news/735921>. Accessed 16/09/2015
- <http://www.bankofengland.co.uk/financialstability/Pages/fpc/default.aspx>.  
Accessed on 12/03/2016
- <http://www.bis.org/bcbs/basel3.htm>. Accessed 02/05/2014
- <http://www.cma.org.sa/En/AboutCMA/Pages/default.aspx>. Accessed 14/11/2014
- <http://www.fca.org.uk/about/structure/committees#RegulatoryDecisionsCommittee>. Accessed 07/02/2016.
- <http://www.fca.org.uk/firms/markets>. Accessed on 06/02/2016
- <http://www.freshfields.com/uploadedFiles/SiteWide/Knowledge/MAR%20fact%20sheet%20241014.pdf>. Accessed on 05/01/2016
- [http://www.fsa.gov.uk/pubs/final/shell\\_24aug04.pdf](http://www.fsa.gov.uk/pubs/final/shell_24aug04.pdf). Accessed on 03/02/2016
- <http://www.ftseglobalmarkets.com/issues/issue-81-march-april-2015/the-long-awaited-opening-of-the-saudi-stock-market-to-foreign-investors.html>. Accessed on 09/01/2016
- <http://www.ftseglobalmarkets.com/issues/issue-81-march-april-2015/the-long-awaited-opening-of-the-saudi-stock-market-to-foreign-investors.html#sthash.bcVACARn.dpuf>. Accessed on 05/09/2015
- <http://www.globaldisclosures.com/Latest-News/3158>. Accessed on 19/06/2015.
- <http://www.legislation.gov.uk/ukpga/2000/12/contents>. Accessed on 07/01/2016.

- <http://www.londonstockexchange.com/exchange/statistics/daily-trading/daily-trading.html>. Accessed on 05/02/2016
- <http://www.londonstockexchange.com/exchange/statistics/daily-trading/daily-trading.html>. Accessed on 21/01/2016
- <http://www.lse.ac.uk/newsAndMedia/news/archives/2009/05/IslamicBanking.aspx>. Accessed on 13/01/2016
- <http://www.slaughterandmay.com/media/1522219/market-abuse-and-the-definition-of-inside-information.pdf>. Accessed on 11/10/2015
- <http://www.slaughterandmay.com/media/1522219/market-abuse-and-the-definition-of-inside-information.pdf>. Accessed on 22/02/2015
- [http://www.tadawul.com.sa/Resources/Reports/DetailedDaily\\_en.html](http://www.tadawul.com.sa/Resources/Reports/DetailedDaily_en.html). Accessed on 05/01/2016
- <http://www.telegraph.co.uk/finance/financial-crime/11483111/Operation-Tabernula-The-story-of-the-biggest-insider-trading-investigation-in-UK-history.html>. Accessed on 05/02/2016.
- <http://www.thetimes.co.uk/tto/business/industries/banking/article4370849.ece>. 10/11/2015.
- Al Nwaisir, S. (2012) 'Saudi Stock Market Needs To Be Reformed'. <http://www.eurasiareview.com/11012012-saudi-stock-market-needs-to-be-reformed-oped/> Accessed 08/03/2014.
- Dr. Mohammad Omar Farooq. The Riba-Interest Equivalence: Is there an Ijma (consensus) (2006). <http://www.globalwebpost.com/farooqm/writings/islamic/r-i-consensus.html>. Accessed 07/02/2014.
- Dubai International Financial Centre Sukuk Guidebook. See also <http://www.islamicbanker.com/education/Sukuk-al-Istisna>. Accessed 11/02/2014
- Financial Times Special Report: The Future of Islamic Finance, December 14, 2010. Available at <http://www.ft.com/reports/library/> accessed 12/04/2013
- FSB report on implementation and effects of the G20 financial regulatory reforms. <http://www.fsb.org/2015/11/fsb-publishes-report-on-implementation-and-effects-of-the-g20-financial-regulatory-reforms/> Accessed 09/01/2016

- HM Treasury, 'A new approach to financial regulation: the Blueprint for reform' (2011) Cm 8083 p.282 [http://www.hm-treasury.gov.uk/consult\\_finger\\_blueprint.htm](http://www.hm-treasury.gov.uk/consult_finger_blueprint.htm). Accessed 10/11/2014.
- IMF (2012). Saudi Arabia: Reports on the Observance of Standards and Codes Available at <http://www.imf.org/external/pubs/ft/scr/2012/cr1293.pdf> IMF Country Report No. 12/93. Accessed 17/06/2014.
- International Organization of Securities Commissions (IOSCO), recommendations for a model law on market abuse 2011. <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD361.pdf> Accessed on 09/01/2016
- John S. (2015) is Middle East Director based in Riyadh for the Ashmore Group. Available at <http://www.arabnews.com/columns/news/761561>. Accessed 25/09/2014.
- List of FCA convictions. Available at <http://fca.org.uk/news/former-equities-trader-pleads-guilty-to-insider-dealing>. Accessed 28/02/2016
- Litigation & Dispute Resolution. Legal Developments April 2007, by SJ Berwin LLP. Available at <http://www.legal500.com/developments/2955>. Accessed on 23/04/2015.
- Martin M. (2015) Will the Tadawul's opening be a turning point for Saudi's economy? Available at <http://gulfbusiness.com/2015/06/will-tadawul-opening-turning-point-saudis-economy/#.VZBIy-fwPV0>. Accessed 21/01/2016.
- Metz, H. C. ed. (1992) Saudi Arabia: A Country Study. Washington: GPO the Library of Congress. <http://countrystudies.us/saudi-arabia/51.htm> Accessed 09/09/2013
- Revoking the Securities Business License of Ernst & Young Saudi Arabia Consulting Limited contained in the CMA Announcements published on 14/03/2010. [http://cma.org.sa/En/News/Pages/CMA\\_N\\_513.aspx](http://cma.org.sa/En/News/Pages/CMA_N_513.aspx). Accessed 15/12/2014.
- Rothband, M. N. (2008), 'Free Market'. The Concise Encyclopaedia of Economic. Available at <http://www.econlib.org/library/Enc/FreeMarket.html>> Accessed on 29/06/2013.
- Saudi Gazette (2012) <http://saudigazette.com.sa/index.cfm?method=home.PrintContent&fa=regcon&>



action=Print&contentid=20120705129018&simplelayoutAccessed on 05/07/2012.

- <http://www.world-exchanges.org/insight/views/wfe-interviews-saudi-stock-exchange-tadawul>. Accessed 13/01/2015
- <https://blogs.cfainstitute.org/marketintegrity/2014/03/18/market-abuse-in-europe-harsher-penalties-for-insider-trading-market-manipulation/>. Accessed on 16/7/2015.
- <https://blogs.cfainstitute.org/marketintegrity/2014/03/18/market-abuse-in-europe-harsher-penalties-for-insider-trading-market-manipulation/> Accessed on 14/7/2015
- <https://www.kingsleynapley.co.uk/news-and-events/blogs/regulatory-and-professional-discipline-blog/the-regulator-insider-trading-knowing-where-to-draw-the-line>
- <https://www.fca.org.uk/news/fca-publishes-rules-on-how-it-will-apply-the-new-accountability-regime>. Accessed on 09/02/2016
- <https://www.fca.org.uk/your-fca/documents/final-notices/2011/fsa-final-notice-2011-rameshkumar-satyanarayan-goanka>. Accessed on 12/03/2016
- <https://www.fca.org.uk/your-fca/documents/final-notices/2015/kenneth-george-carver>. Accessed on 27/9/2015.
- <https://www.gov.uk/government/news/government-issues-first-islamic-bond>. Accessed 12/10/2015.
- [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/343686/UK\\_Sovereign\\_Sukuk\\_PLC\\_Offering\\_Circular](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/343686/UK_Sovereign_Sukuk_PLC_Offering_Circular). Accessed on 19/03/2016